

THE FEDERAL RESERVE SYSTEM

Legislation, Organization and Operation

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PREFACE

Almost a generation of discussion and agitation, with fully ten years of earnest effort to devise a system of banking legislation, produced the Federal Reserve Act. The working of the measure under the stimulus of war conditions and subsequent changes in trade and finance, has transformed the entire structure of banking and business. Today the federal reserve system stands as the very foundation of American commerce, more powerful in resources than any banking system in human history, with a record of unsurpassed service to the nation in time of unique trial.

And yet the reserve system is today sharply under attack, both in and out of Congress. There are many who would either disestablish it or radically modify its constitution; others who would turn its resources and powers to the uses of politics in the narrower sense of the term. In many ways, the system seems to be on the point of repeating the history of the Second Bank of the United States, with perhaps a final experience quite as unsatisfactory even if different in detail. This state of things would seem to show that there has in some respect surely been error or misjudgment on the part of its managers.

If the federal reserve system is to render the service for which it was originally designed, it must overcome the prejudice and misunderstanding that are now evidently gathering about it. If it is to fulfil its entire function as a genuine central banking system, it must retrace its steps in some particulars and evolve a more effective and general type of service. It is already a commanding, rich, serviceable and powerful system of central co-operative banking. Events have given it

a rapid growth, besides overdeveloping it in some directions and perhaps retarding its normal expansion in others. Precisely what must be done to bring it back to its original lines of development, or to direct it along the lines indicated by European banking experience, can be determined only through a careful review of what has already been accomplished.

In the following pages, accordingly, the aim has been to present a detailed historical account of the adoption of the Federal Reserve Act, of the organization of the federal reserve banks, and of the management and direction of the federal reserve system under the supervision of the Federal Reserve Board. To this has been added an appendix in which are included the principal drafts through which the Federal Reserve Act passed in its successive stages, as well as the subsequent amendments enacted by Congress and a few other essential documents. Throughout the volume the plan has been followed of reproducing as chapter appendices the more important data required for a full understanding of the topics covered in each individual chapter.

In thus endeavoring to furnish a complete historical account of the most important phases of federal reserve history, the author has drawn upon his personal collections of data, assembled during the period of his official connection with the Federal Reserve System, and prior to that time with the House of Representatives Banking and Currency Committee. He has also been privileged to make use of the complete files of the Hon. Carter Glass, formerly Chairman of the House Banking and Currency Committee, covering the period of the preparation of the law and including many letters, documents, newspaper cuttings, memoranda, and other items of interest. Where necessary, these have been reproduced verbatim, and at other points information obtained from them has been introduced into the text. Senator Glass has read the entire text of the volume, exclusive of the general appendix, and has made suggestions and recommendations which have been acted upon.

and which have tended greatly to improve the treatment. Very sincere acknowledgments are made him both for the use of his files and for his valuable comments.

Thanks are due to Haggott Beckhart, Esq., of Columbia University, and to Mrs. F. M. Gordon, formerly of the same institution, for assistance in digesting legislative debates and establishing references thereto.

H. PARKER WILLIS.

New York City,
June 15, 1923.

INTRODUCTION

For a long time I have thought it highly desirable that someone having knowledge of the facts should write a history of federal reserve legislation. It has seemed to me that such a contribution to the financial literature of the country was not only seriously important, but could be made exceedingly interesting; and the necessity of it has been accentuated by the many vagrant and irresponsible scribblings on the subject, all incomplete and most of them ludicrously inaccurate. Some of these fulminations should be suppressed, if not for their stupidity, then for the malice which they exhibit; but I suppose to treat them in this fashion would invest them with an importance which does not in reality attach.

Had I been asked to suggest the person best qualified for the task of preparing an authoritative work I would unhesitatingly have picked Dr. H. Parker Willis, who was so intimately associated with the conception and construction of the legislative measure now known as the Federal Reserve Act. When the House of Representatives in the early spring of 1912 decided to enter upon a reform of the banking and currency system, as senior majority member of the Committee on Banking and Currency I was designated by the Chairman of the Committee to take charge of the work; and to the subcommittee thus headed by me was referred the voluminous report of the Monetary Commission appointed by Congress several years theretofore. Subsequently succeeding to the Chairmanship of the House Committee on Banking and Currency, it became my duty to pursue the matter to a conclusion; and being authorized by the Congress to select as adviser to the Committee an expert in the technique of banking credits, I

chose Dr. Willis for the position. For nine years I had known him as professor of political economy at Washington and Lee University in Virginia and as a writer on financial topics for leading public journals of the country. He was keenly alive to the importance of a radical reformation of the old system and his work with the House Committee was marked by such great zeal and devotion, as well as skill, as completely to justify my estimate of his integrity and capabilities. It was with him a work of love as well as of professional pride. Dr. Willis remained with the Committee until the House bill in all its fundamental provisions was enacted into law and then was made Secretary of the Federal Reserve Board created by the act to administer the system; and in this capacity he performed invaluable service.

When advised by Dr. Willis that he purposed writing a history of federal reserve legislation, I readily consented to put at his disposal all the papers in my possession with which to supplement his own data. These included every draft of the bill, all the briefs furnished and testimony taken by the Committee, the minutes of the Committee and of the Democratic House caucus which reviewed the Committee's labors, as well as numerous private papers and personal letters. I also was glad to examine the proofs as the preparation of the work proceeded; and now I am pleased to attest the general accuracy and excellence of that large part of it traversing events with which I have more or less familiarity. Indeed the facts require no reinforcement, since they derive their verity and force from documentary sources and first-hand knowledge.

Entire frankness compels me to say that I do not share all of the author's impressions of the initial attitude of various public men who were, in one way or another, associated with federal reserve legislation, nor would I be willing to participate in some of the criticisms relating to the administration of the system, since my information on these latter matters especially is of a rather casual nature, while Dr. Willis had close observa-

tion of and official contact with such affairs. But with one conclusion I especially desire to concur and that is the statement that but for the firm, irrevocable purpose of President Wilson to reform our archaic banking and currency system and his persuasive, as well as commanding, leadership of the movement, there would now be no federal reserve system. Moreover, I commend, without qualification of any description, as worthy of emulation Mr. Wilson's wise determination to refrain from executive interference with federal reserve administration and his refusal to permit politics to become a factor in any decisions taken. Unless the example thus set by President Wilson shall be religiously adhered to, the system, which so far has proved a benediction to the nation, will be transformed into an utter curse. The political pack, regardless of party, whether barking in Congress or burrowing from high official station, should be sedulously excluded.

Needless to add, I trust this elaborate work of Dr. Willis will be widely read.

CARTER GLASS.

Lynchburg, Virginia,
May 29, 1923.

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THE FEDERAL RESERVE SYSTEM

BOOK I

THE PASSAGE OF THE FEDERAL RESERVE ACT

CHAPTER I

AMERICAN BANKING ORGANIZATION

An Unsolved Problem

After more than a century and a quarter of almost continuous discussion, the question of money and credit, as reflected in the national policy of the United States, remains unsettled. On at least seven different occasions it has supplied the material for political controversy of major rank, and indications are not wanting which suggest that conditions may be shaping themselves for another struggle which may surpass in severity all of its predecessors.

This recurrence of an issue which should be susceptible of settlement upon a purely scientific basis, but which probably is not so susceptible, has been due to failure or refusal to meet disputed questions sincerely and squarely, to deal with them frankly, and to stand or fall by the decision. Problems of money and banking have been insincerely considered in political platforms, neglected or shirked after elections have been won or lost, and always deferred to the future. Business men and bankers have declined to frame an inclusive and equitable system for curing our financial ills and have preferred to see the subject dealt with in what has been called a "conservative" (which has usually meant "piece-meal") way. Politicians have sought to stir up popular discontent because of alleged fault in the distribution of credit, but have failed to propose or further any just and feasible way of dealing with the subject. Some of them have preferred to keep currency and banking problems as a basis of controversy for future campaigns. Failure to deal thoroughly and honestly with what is perhaps the greatest

and most subtle of modern economic issues has been a national error of the first order.

Cycles of Discussion

Discussion of money, banking, and credit in the United States has moved in cycles, a period of interest and political excitement on the subject being followed by some legislative expedient which has usually failed to attain definite results but which has often coincided with an automatic recovery in trade and on that account has been hailed as the cause of renewed prosperity. Thereafter conditions have moved on much as before, until depression or commercial crisis was again used as the excuse for renewed political outcry, followed by a fresh measure of ineffectual legislation.

The last of such cycles prior to the European war produced the Federal Reserve Act, and in so doing yielded a result of far higher quality than had been attained for nearly a century past; yet the question whether the act has realized its object or must be displaced by a successor is still open. Starting in 1893 with the panic of that year, the discussion of money, currency, and credit continued at intervals for two decades, broken only in 1900 and 1908 by two brief intervals of inadequate and ill-considered legislation, before it was possible to focus public attention sufficiently upon banking and currency issues to force the adoption of a broad measure of legislation.

Note Issue Controversy

Entirely characteristic of the banking discussion was the circumstance that, in 1893 when the last great period of debate began, attention should have been directed first of all to the problem of note currency. It was first supposed or even asserted in so many words by bankers, business men, and economists that the evils of the existing credit situation lay chiefly in the silver purchase policy of the United States. Even thinkers of a supposedly advanced order were indisposed to go

further than to demand the correction of existing credit evils through the institution of a better system of bank note issue. So, in the controversy about money and banking which culminated in the presidential election of 1896, the discussion centered upon the so-called "standard of money," or "bimetallic" problem. The Sherman Silver Purchase Law of 1890 having been repealed in 1893 and the maintenance of the gold standard of money having been politically reaffirmed in the contest of 1896, the monetary problem in its purely technical aspect had apparently been settled. The return of what was called prosperity tended to relieve the conditions which had given artificial support to the free coinage of silver and the popular agitation which had centered about a temporary and subordinate phase of the larger question was in a measure quieted.

This should have given opportunity for a calmer and broader survey of the real issue involved in the "financial" controversy. Surprising as the fact is, it yet remains true that the writings of American statesmen and economists during the years after 1890 give little indication of any thorough appreciation of the real issue which demanded settlement. This failure becomes the more striking when the character of our banking and credit system is considered. The nineteenth century had brought to a high state of development at least three general systems of banking: the highly centralized systems of Europe, of which that of Great Britain may be cited as a premier example; the independent charter banking system, of which the Canadian banks offered probably the purest type; and the free banking plan, of which our own national system afforded the main illustration.

Characteristics of National System

In our system of national banking, three chief features stood out with marked distinctness. They included the power to incorporate new institutions practically at will, the lack or prohibition of branch offices, and the issue of notes based upon

a collateral deposit of government bonds. Because of the adoption of the free banking principle, government supervision had been reduced to a minimum. Public control had more and more contented itself during the passage of years with the regulation of individual banking affairs. The maintenance of ordinary honesty in the narrow sense of the term by bank officers, and the observance of a few rough rules-of-thumb in the management of banking institutions were enough to protect a banking institution organized under the national law from attack or even rebuke by the Comptroller of the Currency. In these circumstances, the development of any well-marked code of banking ethics designed to control the doings of bank officials was slow and difficult, while the evolution of standards of public duty which would serve to give to the business a professional status was even more retarded.

Banking Individualism

The growth of a highly individualized system of banking management was in these circumstances to be expected. In later years, when banking reform discussion had reached a more advanced stage, the reluctance, or even refusal, of the more influential bankers of the country to accept any responsibility for institutions other than their own was an outstanding element in the general situation. In the beginning of the banking reform discussion, this reluctance was still nebulous; and, had there been an effort to direct banking thought into scientific channels, a very much earlier advance toward actual improvement might have been made. The struggle over the question of a standard of value, the attempt to substitute the silver dollar—worth at the time perhaps 50 per cent of the gold dollar, which had in effect come to be the established standard of value—is of political rather than of economic, or banking, significance. Apart from the discussion of the Treasury conditions surrounding the issue and redemption of greenbacks, and the fiscal side of the problem presented by the retention

of our national gold reserve as a part of the general funds of the Treasury, the years 1893-96 afford but little of general interest—and practically nothing that might have become at a later date a part of the nucleus of banking legislation or to afford the basis for more advanced thought on the whole subject.

Baltimore Plan

During the years in question, the only idea of general importance or interest in connection with banking which stands out from the general dead level of discussion about the expediciencies or equities of the gold and bimetallic standards of value, was a concept in bank note issue borrowed from a neighboring country—the so-called “Baltimore plan.” This plan, which first came prominently before the public eye at the annual meeting of the American Bankers Association held in Baltimore in 1893, was essentially a proposal to establish a jointly guaranteed system of note currency upon the plan which had been developed in the Dominion of Canada. Canadian bankers had for many years past been tending toward a much higher degree of banking centralization than had previously existed. Operating upon the plan of specially chartered institutions, the number of banks has always been small in Canada, while the growth of the branch system there tended still further to narrow the number of organizations. With a reasonable degree of equality in strength between these note-issuing banks, it had been feasible in Canada to apply, under the law, a system whereby one and all guaranteed each other's outstanding note issues by establishing a joint guaranty fund in the hands of the Dominion government out of which the notes of any failed bank should be paid upon presentation.

The Baltimore plan was essentially an imitation or adaptation of this Canadian guaranteed note issue system, and at first attracted the attention of American bankers as well as their favorable comment. Adherence to the Canadian plan was,

however, founded upon a failure to recognize that in the United States the banking problem was quite different from that which existed in Canada. With a vast aggregate, including thousands of banks throughout the country—even several thousands of national banks—of all sizes and degrees of strength, the principle of joint guaranty for note issues almost necessarily implied that the larger banks of the community would have to take upon themselves a far higher degree of responsibility than would be borne, relatively speaking, by any of the Canadian banks on behalf of its neighbors. The Baltimore plan, therefore, had hardly been initiated before it began to encounter either indifference or actual hostility, so that it figured only to an inconsiderable extent in the so-called currency discussion of the years 1894-96. It was impossible for this question to become a popular subject of consideration until very much more progress had been made in developing the banking issue and in bringing it clearly before the popular eye.

Campaign of 1896

The presidential campaign of 1896, however, had inevitably to be fought out around the monetary or standard of value question as a central issue. In the platform of the Republican party for that year was carried the following "plank":

The Republican party is unreservedly for sound money.
... We are unalterably opposed to every measure calculated to debase our currency or impair the credit of our country. ... We favor all measures designed to maintain inviolably the obligations of the United States of all our money whether coin or paper at the present standard, the standard of the most enlightened nations of the earth.

This "plank," although far from specific, was expected by some to open the way for a general discussion of banking and currency, as soon as the party had been safely elected to office, and was undoubtedly regarded by many of the party leaders as laying the foundation of a serious and careful revision of our

entire national banking system. A victorious party, however, inevitably regards controverted issues in a light quite different from that which has been thrown upon them during their earlier stages. With the Republican party in office in the spring of 1897, very decided reluctance to authorize any positive action began to be exhibited. The question whether any early or positive action could be expected was soon seen to depend very largely upon the activity of business men within the party. That activity, in turn, was promptly recognized as conditioned in no small degree by the ideas and wishes of the bankers of the country. Without some display of interest in the whole problem, it was plainly evident that the party would, as so often in the past, allow its pledge to go unredeemed, at least for the early years of its lease of office, and accordingly various elements in the business and banking community began to bestir themselves with a view to crystallizing opinion in the dominant political organization and obtaining from it definite decision as to the direction to be taken by legislation.

Indianapolis Movement

The movement to which reference is thus made assumed form in what was known as the Indianapolis Currency Convention, at which was appointed the so-called Monetary Commission, whose sessions began in Washington in the late summer of 1897, and continued for several weeks thereafter, eventually culminating in a general report to Congress backed by the submission of data and argument intended to establish the necessity for early action looking to the correction of banking evils.¹

So fully has the Indianapolis currency movement been dis-

¹ The general history and recommendations of this commission are found in its report (University of Chicago Press, 1898). In addition, various magazine and newspaper articles contemporaneously appeared, though none that adds information of material value to what is contained in the report. The files of the Commission, its minutes, and records, contain a considerable additional amount of useful data. The author was (jointly with L. Carroll Root) assistant to the Indianapolis Commission, and in that capacity has had access to sources of information not otherwise accessible, though in no sense confidential, being withheld from publication merely owing to considerations of expense and lack of general interest in them.

cussed in histories of currency and banking, that little more than a passing reference to it is necessary; and even that only for the purpose of fitting it into its proper relationship in connection with other phases of the movement here under consideration.

The Indianapolis currency movement has been variously regarded as the origin of the entire banking reform agitation and as having been merely the source from which inspiration was drawn for the adoption of the Standard Act of 1900. As a matter of fact, it was not exclusively either of these but in some measure partook of the nature of both. The movement was essentially a specialized bankers' movement. Although it professed to seek the interests of the public at large, and although the Monetary Commission appointed by it contained only one or two banking members, it was predominantly financed by national banks and was from the first unlikely to recommend anything that ran essentially counter to their interests. This in itself would have, of course, greatly limited the efficiency of the organization and prevented it from exercising that broad influence that it might otherwise have had. In so far as the source of its support was known, the movement, of course, became more or less suspect in the popular mind, which tended to identify it with the so-called "financial interests." Such, however, was the condition of the banking system at the time that the chief interests of bankers in the matter of legislative reform were in no wise directly or in all respects in conflict with those of the public. The first and most urgent changes then needed were primarily such as represented the views of the banks, but they were also such as represented far more broadly and greatly the requirements of the public.

It was therefore measurably true that the Indianapolis currency movement was a public-spirited movement—one whose purpose it was to further the well-being of the community. There was certainly enough to recommend it to the interests of any section of the community, and while it maintained

throughout its whole existence the essential character of a bank-inspired undertaking, it undoubtedly was to be reckoned with as a movement of more or less national scope and of a reasonable degree of public spirit. Yet precisely because of this limited character of the movement, and in no small degree because of the elementary condition both of economic and professional thinking at the time on the subject of banking and currency legislation, the Indianapolis Currency Commission was restricted to very narrow limits in its work.

Recommendations of 1898

Meeting in Washington in September, 1897, it devoted a few weeks to summarizing the general requirements of the country and to the formulation of a bill for presentation to the President and to Congress. Thereafter, for purposes of agitation and propaganda it developed, under the supervision of one of its members,² a lengthy report covering the whole field of banking and prepared by assistants to the Commission who had been retained for that purpose. This lengthy report was combined with the preliminary report which had been written with the direct participation of the full membership of the Commission itself. The two documents jointly embodied the Commission's recommendations and were published in a large volume which received a considerable circulation. This book may be regarded as summarizing and reflecting the then general position of current banking and economic thought on the subject of reform legislation of the United States. The essential ideas of the work were two in number, being as follows:

1. Provision for the issue of a bank note currency based upon commercial assets and therefore eventually in accordance with the volume of business, such currency to be jointly protected or guaranteed by the banks which joined in issuing it.

² Professor J. Laurence Laughlin, then of the University of Chicago.

2. Termination of the Independent Treasury system in some of its chiefly objectionable aspects and separation of the funds used for the protection of the greenbacks so as to give them an independent status.

Subordinate to these main features of the report were several less prominent but of very considerable significance. They included refunding of government bonds, provision for branch banking, and a number of others which eventually found a complete or partial development in the Federal Reserve Act fifteen years later. These thoughts, moreover, were embodied in the bill recommended by the Commission and were thus placed before Congress in a concrete form which that body might have used as a basis for action had it at the time felt so disposed.

Congressional Opposition

But such action was far from the intention of Congress. It was at that time almost a cardinal principle of politics with the leaders of the Republican party to do as little as possible with the currency and banking question. They had found it a stone of stumbling in connection with the preceding presidential elections, and they knew that their own membership was far from being a unit with reference to the proper lines of reform.

Although the presidential election of 1896 had been won distinctly upon the currency question as an issue, the Republican leaders early determined to avoid action on the question, so far as possible, for several years to come. In pursuance of this end, Speaker Reed united in the Banking and Currency Committee after 1896 as many incongruous elements as possible. Mr. Reed reasoned, and with accuracy, as the event showed, that the presence of these divergent elements on the Committee would insure the inability of the Committee to attain any unanimity of opinion and would necessitate a continuance of the divergence of view which had already become

characteristic of the leaders of thought on banking and currency legislation. The Banking and Currency Committee fully warranted the expectations which had been entertained with reference to it, periodically submitting reports which, either were supported by a bare majority of the membership, or were merely submitted by the chairman without the concurrence of his associates save in the most formal manner, if at all. This example was followed by succeeding speakers, both Mr. Henderson and Mr. Cannon pursuing the plan of maintaining the Committee in an ineffective condition. Although, therefore, the Banking and Currency Committee, from 1897 to 1908, was one of the most active of the committees of the lower house of Congress, it never succeeded in getting the slightest attention for its reports or recommendations.

Effect of Spanish War

Even had there been no extraneous factors in the way, it might thus reasonably have been expected that currency and banking legislation would have been subjected to great postponements. But as matters stood, it was not necessary to resort to any elaborate legislative readjustment. The Spanish-American War, which came very soon after the Indianapolis Commission had completed its final work, diverted the attention of the public wholly from technical subjects, and although the war was soon over, it left behind it much in the way of new issues which effectually prevented the concentration of any serious attention upon financial questions. The years from 1897 to 1900 are, therefore, practically barren in so far as real progress was concerned. But with the advent of a new presidential campaign in the year 1900, politicians began to inquire in their own minds whether the currency and banking question might not once more serve as an issue. That it should do so effectually seemed to require the adoption of some measure of legislation and accordingly the party reluctantly took the whole question in hand.

Gold Standard Act

Since, for reasons already noted, the Republican machine organization which controlled the lower chamber had acquired the habit of acting without reference to the Banking and Currency Committee whenever it thought best to pass some legislation relating to the currency and banking question, the subject was taken away from the Banking and Currency Committee of the House, and a little ring of leaders, meeting at Atlantic City, New Jersey, shaped what later became the so-called Gold Standard Act of March 14, 1900. It would be absurd to say, as some have done, that this action was taken "at the behest of the bankers of the country." The bankers desired nothing more at the time than that the plans of the Banking and Currency Committee of the House should be carried out in some form, or that the plan which had been perfected by the Indianapolis Currency Commission should be taken up for consideration. They did not approve of the defective and incomplete provisions of the Gold Standard Act of 1900, though they recognized that the act was better than nothing. The measure of 1900 was essentially political in its origin and purpose, and contained vicious features which nearly offset the better qualities unquestionably possessed by certain of its sections. It had, in fact, all the marks of a bill hastily shaped in secret by a group of politicians none too well informed upon the topic they were treating, and, though equipped with the raw material on which to work, ignorant of the proper methods by which to form the measure they were planning.

Changes in Banking Situation

The Currency Law of 1900 must be regarded as only in a very limited sense a stepping stone toward general banking reform legislation. Its essential ideas were three in number: (1) the making of definite provision for the greenbacks by providing a fund of \$150,000,000 permanently recognized as a

redemption fund with power to the Secretary of the Treasury to reconstitute it in the event that it should become depleted; (2) provision for the better satisfaction of banking needs throughout the country, not through the establishment of branch banks but by lowering the minimum capitalization of national banks to \$25,000; (3) provision for a more abundant currency by the refunding of the outstanding government bonds into consols bearing only 2 per cent, which it was supposed would be a rate of interest low enough to make the bonds unattractive for any purpose save that of supporting circulation, so that the entire volume of those in existence could be counted upon as a basis for note issue. Incidentally, the Currency Act of 1900 undertook to fulfil the pledges of the Republican party as to the monetary standard by declaring that a gold dollar of existing weight and fineness should constitute the standard unit of value into which all other money and currency should be convertible. It may well be questioned whether this declaration was of much importance, since no satisfactory provision was made for maintaining the gold standard.

It will, therefore, be observed that only in one real respect did the Currency Law of 1900 meet the demands of those who had been urging reform. This was in those sections where a definite support for greenbacks was established, and even this provision was unsatisfactory, because of the general admission that the greenbacks were in and of themselves undesirable as a standard currency, and that their evils could never be cured save by complete retirement of the outstanding issue. The other provisions of the law—the reduction of the capital of national banks and the refunding of the bonds in such a way as to make the bond currency rather more available and more abundant, were reactionary measures. They continued and emphasized those features of the National Banking Act which had been adjudged undesirable on the basis of nearly forty years' experience and they very materially tended to weaken the banking system, as the numerous failures among the small

banks afterwards abundantly demonstrated. The Act of 1900, however, at least provided a basis for the argument that the party had complied with its pledges, and constituted an alleviation of the most immediate and most urgent difficulties growing out of the national bank organization. It was not satisfactory to bankers or to those elements of the public who had devoted serious thought to the banking and currency situation, and there were probably few, if any, who expected of it anything more than a kind of makeshift help in the existing situation. Congress, however, was now in the hands of men who were firmly resolved not to permit any further change to occur and whose cardinal policy was that of avoiding disputed issues to the end that party harmony might be preserved and that as little cause for any division in the party ranks might be provoked. It was evident from the time of the 1900 presidential election onward, therefore, that no very decisive action could be expected in any near future. Those who were best instructed in American politics quite clearly recognized that probably another period of panic or commercial disaster would be necessary to provide the impetus that must be had for any new discussion of banking and currency.

Working of Act of 1900

The Act of 1900 on its banking side soon demonstrated that the fears of those who had so seriously doubted its wisdom were well founded. Small banks multiplied rapidly—so rapidly, in view of the need of currency to meet the country's expanding requirements, that the great bulk of the national bonds were soon absorbed by the banks. Autumnal stringencies due to the recurrent demand for currency became more pronounced than ever, and alternated with periods of relaxation and over abundance of money which tended to stimulate stock speculation. An inflationary growth of business drew heavily upon the resources of many of the banks, and prices tended fairly steadily toward higher levels. The Secretaries of the Treasury

during the first six or seven years of the new century found themselves busied with ways and means of rendering the inelastic bank currency slightly more available and interpreted the National Banking Act in ways that would permit some of the greatest hardships of the law to be mitigated. The evils of bad bank practice grew apace, for national banks were now so numerous that it would have been difficult for even a very efficient federal corps of examiners to keep close watch of so many widely scattered institutions. With the utmost of diligence and single-mindedness, the Comptroller of the Currency could do little more than to repress the more glaring abuses. It became apparent, as time went on, that local or district examination under the supervision of the banks themselves was capable of becoming far more efficient and satisfactory than national or central examination. In some of the states, the examination installed by the superintendent of banks was more thorough than that of the federal government over the national institutions, chiefly because of the smaller number under his charge and because of the greater uniformity of practice and method in the various localities.

Work of Charles N. Fowler

These factors were still in operation and were only gradually appreciated as year after year brought out into clearer light the real working of the National Banking Act as revised in 1900. Yet, from the year 1900 onward, the banking and currency question was practically untouched in Congress so far as any practical work in relation to it was concerned. Only in the House Banking and Currency Committee was the discussion kept alive, and even in that organization only because of the fact that an enthusiastic advocate of sound and scientific legislation happened to be at the head of the Committee. This was the Hon. Charles N. Fowler of New Jersey, whose interest in the subject had led him to devote much of his time and thought to the general question of federal legislation, and who

in the course of his lengthy study and analysis of the question had become thoroughly familiar with the best writings of leading authorities. Mr. Fowler developed a series of bills during the decade 1900-1910 and devoted himself to continuous effort for their promotion. He labored long and earnestly with the leaders of the House of Representatives to secure attention for his measures, and endeavored his utmost to focus upon them the best thought of the academic and financial community. In the latter effort he was measurably successful, but in the former his work had but little success.

For reasons which have already been sketched, the legislative leaders had made up their minds not to commit themselves to any definite program upon banking and currency, and with the machinery of the House of Representatives fully under their control, they possessed absolute power to strangle or further any measure of legislation as they might see fit. Perhaps there has never been a series of years in the federal legislative body so depressing to believers in genuine democratic government as the decade 1900-1910. Seldom has there been a period when so autocratic a rule prevailed at Washington, or when there were so few stirrings of independence or so little regard for the popular welfare as was to be observed in Congress. It was not strange, therefore, that the banking and currency situation should be refused attention. How long this state of things might have continued, had it not been for the development of commercial difficulties of the first rank, can be only a matter of conjecture.

Financial Dangers

These difficulties were not slow to assert themselves. The inflation and bad banking to which reference has already been made would in due time have brought their own retribution, but coupled with them were other elements of danger in finance. These factors, jointly acting without control or check, produced in the early part of the year 1907 a situation of very

serious hazard from the financial and banking standpoint. It had become clear early in that year that many banks were heavily overloaned, and that their great expansion in business had been financed upon an inadequate basis of security. Prices in many lines had become inflated, and the banks of the country were in no position to protect themselves should any very severe strain be brought to bear upon them. Neither was the government in position to assist in relieving conditions, for its surplus, although considerable on paper, was of very much less significance after necessary deductions representing various trust fund obligations had been made. In fact, the government could not safely use its available balance for bank relief through deposits of public funds except to a limited extent.

Panic of 1907

The storm which had thus been gathering burst in the early autumn of 1907, and resulted in a widespread series of bank failures, accompanied by suspension of specie payments and joint action on the part of banks in the principal cities to develop some means of immediate relief. Their action was more or less successful, and within a reasonable time confidence was measurably restored and the effects of the panic were gradually overcome. It had, however, furnished the necessary warning as well as the impetus which was required for the undertaking of new legislation in Congress. The Roosevelt administration, which had previously declined to give much attention to banking and currency subjects on the ground that they involved no questions of moral principle, was shaken out of its attitude of indifference and the President himself expressed the belief that reform legislation was needed. The consequence was the Currency Law of 1908, ordinarily referred to as the Aldrich-Vreeland Act, whose evolution will be fully studied in a later chapter.

This law, like that of 1900, wholly rejected the general teachings of scientific writers and the lessons of European

experience. It adhered to the idea of bond security behind bank notes and only in a halting and inadequate way provided for the use of commercial assets as the basis of currency. In deed, so wholly unsatisfactory were its provisions in the latter particular, that not until six years after the adoption of the law were its provisions on this score ever actually availed of. Meantime the National Monetary Commission had been formed under the provisions of the Law of 1908, and had developed what came later to be known as the Aldrich or National Monetary Commission bill. It was the great merit of the Aldrich bill that it at last turned away, only partly, to be sure, from the bond-secured currency idea and reverted partially to the older series of banking measures which had been broken at the time when the Second Bank of the United States ceased to function. The Federal Reserve Act, in displacing the Aldrich bill, pursued the same course of thought as that which had been represented in the early central bank legislation of the United States.

Recurrence to Scientific Analyses

Thus after a period of struggle, lasting continuously for more than twenty years, analysis of banking and currency conditions had at length been shifted back to its proper channels and the unscientific experimentation initiated at the time of the Civil War had been laid aside. It is not strange that in this tangled course of controversy and with a banking community as widespread and as various in its antecedents as ours, it should have been found difficult to concentrate the attention of the community at once upon the primary facts. That must necessarily be a slow process. Experience under the Federal Reserve Act has shown how slow and how difficult it inevitably is. The Federal Reserve Act, indeed, instead of being the culmination of a period of discussion is merely the culmination of a period of agitation and the beginning of a period of discussion. It is an epoch-making measure in American finance, but

it is so because it marks the return of public thinking into the recognized channels of banking thought. That is the reason why the careful study of the struggle which produced the Federal Reserve Act is of interest. It is not merely a chapter in financial history; it is also an account of the first battle in a campaign for safe and scientific banking that has only just opened.

The Present Outlook

This statement was true at the conclusion of the struggle which ended in the adoption of the Federal Reserve Act in December, 1913; it is even truer today. Those who were hostile to the act itself or who did not believe in its provisions gradually succeeded, as will be seen in later chapters, in changing the character of the system through the introduction of amendments whose effect has in but few cases been salutary or successful. Whether this opinion be correct or not with regard to the effect of such amendments, it will be conceded by all and not least by those who were responsible for them, that the amendments in question were designed to alter considerably the original scope and intent of the legislation and that they have succeeded in so doing. There is therefore an open question as to the difference in policy which is represented by the original Federal Reserve Act in its later and amended form.

- The war introduced great changes into the structure of the legislation, although at the time they went very largely unheeded, owing to the pressing character of the issues which were then demanding attention. Not only was this true but, through interpretation and through changes in Treasury policy, the working of the Federal Reserve Act came to be greatly altered, so that at the close of the war the changes in its actual effect which had taken place in one way or another had produced results as great perhaps as those which might have occurred in the course of a generation passed in quieter and less

feverish times. There were pending before Congress at the close of 1922 many bills whose effect, should they become law, would be to change enormously both in spirit and in detail the working of the new legislation. We may therefore regard the future of our banking structure as entirely problematical—not even the accepted principles upon which it is to proceed having been determined. There seems less likelihood than in the past that it will become entangled with the money controversy and yet such a possibility is always present, as is seen by the recurrence of extreme and heretical monetary notions sponsored by eminent business and scientific authorities during the years 1921 and 1922.

The recurrence also of the demand for class legislation, intended to alter the position of the agricultural elements in the population by giving them the use of abnormally cheap capital on long term and by enabling them to draw such capital from the federal reserve banks, is reminiscent of the campaign of 1896, and suggests that the issues involved in that struggle may have to be largely renewed. Nevertheless it remains true that the interest of the community has shifted for the time being from the older controversies about the money standard to those which relate to credit and banking.

Lack of Agreement

It is these topics that will unquestionably form the center of active controversy both in Congress and out of it for a good while to come and may, indeed, become the nucleus of a struggle of national proportions. Even if this danger should be avoided, it still remains true that there has thus far been little or no success in concentrating the attention of the people at large upon the real fundamentals of the banking problem. There is only a limited consensus of opinion even among financial authorities as to the elements of a sound banking system, or the principles upon which it should be conducted. Such success as has been had during the past eight years in

the operation of the federal reserve system has by no means wiped out the prejudice which formerly existed in favor of a more centralized system, and it may well be expected that from time to time the issue which formed the center of controversy during the struggle over the Federal Reserve Act will be resumed and sharpened. What will bring it eventually to a definite adjustment can only at this time be conjectured. The history of the Federal Reserve Act at all events shows the alignment of existing financial, industrial, and agricultural political groups and thus throws light upon the probable future of the banking controversy.

CHAPTER II

THE TREASURY AND THE BANKS¹

Government in Relation to Business

In almost all countries, the "relation of the government to the banking business" is a primary problem of current twentieth century politics. It has long been a foremost issue in American politics, and never more so than at the present day. The form and characteristics of this problem have, however, greatly developed within recent years, and the issue today is totally different from its older form.

During the years after 1893, the cry "take the government out of the banking business" came to be accepted by "sound money" advocates as representative of a demand whose basis was almost axiomatic. It meant, in those years, primarily the elimination of the greenbacks as being a constant menace to the stability of currency, and to some at least it signified the withdrawal of the government from the business operations connected with the operation of the Independent Treasury system.

In these aspects the demand possessed both sound and unsound elements, but the reasonable basis of the request was apparent and controlling. In every serious effort to get "currency reform" legislation after 1893, therefore, some reorgan-

¹ During the years 1901-1912 the author was either in charge of the Washington Bureau of the *Journal of Commerce and Commercial Bulletin of New York*, or was detailed as special correspondent; and when in Washington (except during 1903-1904, when not a member of the *Journal of Commerce* staff) was assigned as his primary duty the following of Treasury policies from day to day. This chapter is based on the despatches and articles then written by him and appearing from day to day during the years in question. Facts set forth in these despatches were the outcome of personal inquiry, and information received from the financial officers of the government. Needless to say, the opinions herein expressed are his own.

ization of the Independent Treasury system, some revision of relations between the government and the banks had an important place.

From the administrative standpoint, too, it was to be expected that there should be an important connection between the government and the banking system. With the banking system vitally defective in its most essential elements, it was necessarily inevitable that there should be effort on the part of the government to make up for what was lacking or amiss. For such action the machinery was provided by the Independent Treasury system first adopted in 1846 and reapplied after the Civil War; while a precedent was found in the debt and surplus financiering of 1886 and the following years.

Attitude of Public Men

The most annoying feature of the banking and currency situation after the year 1900 is found neither in the defects of existing law, nor in the methods employed by the government in dealing with current problems, but in the attitude both of public officers and of members of Congress. "Tell them that we do not want any of their rubber currency, but that the National Banking Act which carried us safely through the Civil War is good enough." This sentiment expressed by one of the all-powerful coterie which controlled the House of Representatives for some time was intended as a reply to one who had visited him to urge the necessity of what was then called "currency reform." The "rubber" currency referred to was intended as a jocose reference to the "elasticity" of circulation of which much had been said by writers on the banking and currency question, while the anachronistic reference to the Civil War and the national banking system was more nearly intended as a warning that banking reform would be opposed by the leaders of Congress on the strength of an appeal to popular prejudice on the monetary question than it was meant as a legitimate appeal to reason. At all events, the words

quoted stand fully and fairly for the attitude adopted in all branches of the government during the years after the election of 1900 and prior to the advent of the panic of 1907.

Secretary Gage

The administration of the Treasury under Secretary Gage had been largely concerned with the Spanish War and its sequelae, and there had been but little occasion to deal directly with, or perhaps think very seriously about, the general problems of currency and banking. A different situation set in when President McKinley was succeeded by President Roosevelt, Secretary Gage soon after withdrawing and being followed by Secretary Leslie M. Shaw. The latter found some serious problems facing him at the very outset early in 1902. The Act of 1900 had already shown its inadequacy; while, as a result of the revenue measures adopted for the support of the Spanish-American War, the Treasury was in receipt of large incomes which tended to accumulate in its hands.

In a sense, the problems thus presented for solution were the same as those of the first Cleveland administration, when an overfull Treasury was partly emptied and the surplus funds returned to common use by the plan of buying in bonds in open market, paying for them in cash. The process had had its own evils then, but it was no longer practicable. Under the Act of 1900 the older circulation bonds had been largely refunded into two's and these were being, from year to year after 1900, "put up" with the Treasury as security for circulation, so that to buy them in (even had conditions otherwise made it worth while) would have been to work against the little element of pseudo-elasticity which remained in the national banking currency.²

² The following table outlines the movement in the volume of gold coin and bullion, federal reserve notes, federal reserve bank notes, national bank notes, and total money in circulation, which includes in addition silver dollars, subsidiary silver, and United States notes:

New Problems of Treasury

The efforts of the Secretaries of the Treasury who succeeded Mr. Gage were thus naturally and necessarily directed along lines rather different from any that had been pursued in the past. It was essential for them to get surplus funds out of the Treasury and into circulation; and it was equally imperative to provide a method of "relieving" hard-pressed banks both at times when pressure made itself felt as a result of individual bank needs due to overlending, and at those other times when the condition demanding attention was a more general or sectional necessity growing perhaps out of so-called "crop-moving" or similar requirements.

In finding a method of eliminating Treasury surpluses, the natural plan might have been that of curtailing taxation. But just here obstacles were interposed by the peculiar fiscal system of the United States. Deriving the great bulk of its receipts from the tariff and internal revenue duties, the federal government found difficulty in adapting its income-raising system to its expenditures, particularly as the Republican

MONEY IN CIRCULATION

Fiscal Year	Gold Coin and Bullion*	Federal Reserve Notes	Federal Reserve Bank Notes	National Bank Notes	Total Money in Circulation	Percentage of Gold to Total Money
1900...	\$1,034,384,444	.....	.....	\$309,640,444	\$2,339,700,673	\$44.21
1901...	1,124,639,062	.....	.....	353,742,187	2,483,067,977	45.29
1902...	1,102,594,580	.....	.....	350,672,091	2,553,266,658	46.53
1903...	1,248,681,528	.....	.....	413,670,650	2,684,710,987	46.57
1904...	1,327,656,308	.....	.....	449,235,095	2,803,504,135	47.35
1905...	1,357,655,988	.....	.....	495,719,806	2,883,109,864	47.09
1906...	1,475,706,765	.....	.....	501,112,350	3,069,975,591	48.07
1907...	1,460,389,101	.....	.....	603,788,690	3,115,561,007	47.06
1908...	1,618,133,492	.....	.....	608,333,677	3,378,764,020	47.99
1909...	1,642,041,999	.....	.....	689,920,074	3,466,328,354	48.21
1910...	1,636,043,478	.....	.....	713,430,733	3,419,591,483	47.84
1911...	1,753,190,722	.....	.....	728,194,508	3,555,958,977	49.30
1912...	1,818,188,417	.....	.....	745,134,992	3,648,870,650	49.83
1913...	1,870,761,835	.....	.....	759,157,909	3,720,070,016	50.28
1914...	1,890,656,791	.....	.....	750,671,899	3,738,288,871	50.58
1915...	1,985,539,172	\$ 84,260,500	.....	819,273,593	3,989,455,186	49.77
1916...	2,440,739,010	176,168,450	\$ 0,000,000	744,174,660	4,482,891,938	54.05
1917...	3,019,146,563	547,407,900	12,790,245	715,420,010	5,407,990,026	55.83
1918...	3,075,788,838	1,847,580,445	15,444,000	724,205,458	6,741,072,294	45.03
1919...	3,113,168,661	2,687,556,985	187,066,980	719,276,732	7,605,366,571	40.03
1920...	2,790,463,700	3,405,877,120	201,225,800	719,037,730	7,900,998,090	34.25
1921...	3,207,720,834	3,000,429,860	150,772,400	743,390,374	8,000,006,237	40.72
1922...	3,784,651,712	2,555,061,660	80,495,400	758,202,027	8,177,477,105	46.28

* Does not include gold bullion and foreign coin outside of the vaults of the Treasury federal reserve banks, and federal reserve agents.

party, then in power, had always protested against the varying of tariff rates with an eye chiefly directed to their revenue bearing. Surpluses, moreover, varied greatly in amount from year to year—in short, it seemed wholly impracticable to control them through a national budget system.

Volume of Revenue

These circumstances practically dictated the resort to direct deposits of government funds in banks, a plan pursued at times in former years, though never on a scale so great as was now to be employed. The deposit idea was itself wholly out of harmony with the general concept of the Independent Treasury system, being, indeed, a confession that that system could be applied in its pure form only so long as revenues were received at about the rate at which they were disbursed. Although today we look back upon the expenditures of the government prior to the European war with something akin to surprise because of their smallness, seldom reaching \$1,000,000,000 in a single Congress, they were then viewed from a quite different standpoint. It was, in fact, true that under the Independent Treasury system which then existed the receiving and disbursing of a billion dollars in the course of a single year caused considerably more disturbance to business than a turnover of several times that amount today. Prompt and efficient systems of redeposit were accordingly recognized as essential in order that surpluses might be kept out of the Treasury and in the hands of the active business men and producers of the community where they, "belonged."

The "Pet Bank" System

It was in such conditions that there was rapidly built up the obnoxious "pet bank" system, which exerted so injurious an effect upon financial conditions and was speedily recognized as constituting a serious menace to true currency and banking re-

form. A beginning had been made by placing the bulk of the surplus funds of the Treasury with city banks and particularly with those in New York. The practice inevitably tended toward scandal, since it was not long before some of the larger institutions which themselves were heavy lenders in the stock market began to exceed the bounds of prudence, in the belief that at almost any time they could count upon getting aid from the Treasury in the form of special government deposits.

Largely to offset the politically hazardous consequences of such a state of affairs, the practice of distributing funds among country banks began to assume much greater development, for it was plausibly argued that the funds ought in as large measure as possible to go back to the people from whom they had been drawn. Yet the difficulty of continuously using the country banks was great, since exchange drawn upon institutions far from Washington was not readily available, while even where depository banks were required to return to the government New York, Chicago, or other metropolitan exchange, the process of depositing and withdrawing funds in such circumstances was not easy. Thus developed the practice of recognizing two classes of depositories, the "active" and the "inactive" institutions, and the latter before the end of the decade came to number fully 1,400. They were "pet banks" in a very real sense, since the deposits with them were made for no definite purpose save to get the funds "out," and the banks merely regarded them as a temporary loan on which they might make some additions to earnings, since in the years before 1908 they paid no interest and during the years thereafter only a nominal rate.

Disturbance of Money System

In the majority of cases it was doubtless true that these pet bank deposits never went in fact to the localities where the depositories were located. The bulk of government receipts being paid to the Treasury at a very few points, the

deposits took the form of Treasury warrants on New York or Chicago, usually the former. Such a warrant drawn in favor of some small country institution, and often exceeding its capital, was habitually deposited by the recipient with its city correspondent, and was by the latter received subject to interest. It constituted "reserve" for the country bank and permitted the latter to expand loans locally so far as it dared or could find borrowers, while the reserve agent or city correspondent, since it paid interest, must also earn it. This it did by relending in the stock market, so that, no matter whether the funds of the government went directly into city banks or reached those institutions only through the intermediation of country banks, they were essentially employed for the nourishment of the stock market.

Crop-Moving

There was one conspicuous exception to this general state of things. Recurring or seasonal needs in the rural sections of the country for crop-moving funds often found the local banks "loaned up." When in this condition, they frequently asked for and received from the Treasury, special deposits which they converted into bank notes in New York, using the proceeds in direct loans to their farmer borrowers. Yet these crop-moving deposits, like the Wall Street deposits already described, had their bad reflex effect. They habituated both the depository banks and the communities dependent upon them to the thought of government aid—to the point of view which regarded it as a public duty that the federal government should help all parts of the country which found themselves at any time short of funds. This activity or participation of the government in the "banking business" received little attention—none of an adverse sort—yet it was largely responsible for the later insistence upon publicly aided farm credit which has since become so menacing an element in contemporary American politics.

Cramping the Circulation

While the Treasury policy in forcing out the deposits into bank use was thus almost wholly injurious in its effects, the co-ordinate phase of the policy which had to do with the increasing of circulation was but little better. Under then existing laws, bank deposits were required to be collateraled with government bonds. It followed, therefore, that as the volume of deposits increased, the volume of bonds available to protect circulation decreased. Success in placing surpluses in banks meant further reduction in the expansive power of the currency. Secretary Shaw in part met this difficulty by an evasion or interpretation of the law which permitted the substitution of municipal and railroad bonds behind the deposits, thus reserving the government bonds for use in support of new note issues. He sought every means of relieving the tedious delays previously incident to bank note issue and unquestionably succeeded in reducing the time required for supplying them. Banks were encouraged to order notes in quantity ahead of positive needs, and there was a reduction of routine operations which resulted in prompt shipment of the currency as needed. The banks themselves developed the system whereby national bonds held by fiduciaries as investments were lent for a moderate consideration to institutions that desired to issue notes.

By all these expedients but a slight margin of elasticity was lent to the currency. The notes moreover showed themselves wholly unresponsive to the variations of commercial need. As they were returned from the country districts after the peak of crop-moving demand had passed, they were seldom retired in volume, but instead were used as a basis for market loans, figuring in the reserves of state institutions, although debarred by law from occupying a similar position in national banks.

Financial Ethics

Thus as the years passed the conditions were conducive to a progressive increase of stringency and a progressive decline of

power to relieve banks and public necessity. They grew more and more ominous. The time was a period of unusually low financial standards of ethics. It was the time of the insurance scandals in New York, of much illegitimate promotion and stockjobbing, of governmental dishonesty, as exemplified in the postal and cotton scandals, and of generally discreditable market conduct. Stock trading and trading in commodities were characterized by the use of methods that were subject to grave suspicion. The epidemic of scandal-mongering, which came to be known as "muck-raking," was the legitimate issue of actual financial and economic conditions in public and private life.

It was a startling fact that in this dangerous state of affairs some public officers should have accepted and defended the prevailing state of things and have sought to show that it was perhaps the best that could be devised. Secretary Shaw definitely sought to defend the whole Treasury system as established by existing law, and asked Congress for a fund of \$100,000,000 with which to "play the market" as occasion might demand, depositing coin in the banks or drawing it out, according as it was desired to make bank credit cheap or expensive. The final result of this indifference or acceptance of vicious conditions was the panic of 1907, which must ultimately be traced to the refusal of congressional leaders to permit legislation, the indifference and contempt of President Roosevelt toward the whole issue as "not involving a moral principle," and the acceptance of Secretary Shaw of a dangerous situation which permitted him to play with the high explosives that an unwise currency and banking system had stored within his reach.

The coming on of the panic concentrated the attention of the country on the need of legislation, for the panic of 1907 had not been expected. There was still a large surplus in the Treasury despite reckless appropriation of money, and a substantial degree of prosperity throughout the country. The

inflation of securities which had been in progress, and the illegitimate financing of industrial enterprises, later to be reflected in public prejudice and dissatisfaction, in political revolution, and in popular demand for investigation and anti-capitalistic action, would not ordinarily have borne fruit until a much later date. These conditions stimulated the development of unsound banking, and the panic of 1907, essentially a credit collapse, was the outcome.

Effect of Panic of 1907

Besides bringing the general question of banking and currency reform effectually to the front, the panic of 1907 greatly emphasized the public aspect of the situation and the necessity of making measures of reform bear directly upon Treasury relations to banking and currency. This fact is well worthy of special note. It has already been observed that during the years in question banking reform agitation had been conducted almost entirely by bankers. In but few cases had the business public in the proper sense of that term become seriously interested. Bankers had directed the discussion, bankers had financed it, and bankers had kept it alive.

This from one point of view was highly to the credit of the banking community, notwithstanding that it was patent to every careful observer that a main motive in the continued maintenance of the discussion was the desire to obtain opportunity for the earning of larger profit through a freer issue of notes. There was in this no impropriety, since the professional objects of the bankers in this particular instance happened to coincide with the dictates of sound monetary and banking philosophy. But the almost exclusive control exercised by bankers over the direction of the discussion explains why it was that practically little or no attention was devoted to the incidental effects of the Treasury system which had proved most evil in their influence notwithstanding that they had contributed largely to the profit-making power of the bankers.

Bankers, in other words, sought to correct the bad features of existing legislation where these were hostile to higher profits, but were far less concerned to correct other and worse defects whose tendency was to enlarge profits instead of reduce them.

The panic of 1907 served, therefore, an important purpose in once more popularizing the issue of banking reform and in emphasizing the relation of the public and its funds to the whole situation.

Government and the Panic

No phase of the panic of 1907 itself is deserving of closer attention than the relation which was borne to it by the government and by the Treasury Department particularly. The occurrence of the panic was undoubtedly a surprise to many if not most government officers and was exceedingly unwelcome to them because of the fact that in those days the party then dominant in national affairs had strongly emphasized the statement that its currency and banking policy had invariably been sound and had successfully kept the community from financial or economic disturbance. Politically, therefore, the panic was most unwelcome, while practically the government found itself in very difficult straits when it attempted to stop the further progress of the disturbance.

Comptroller of the Currency Ridgely, who was then in office, had seen distinct symptoms of danger in the spring of 1907 and had done what he could to relieve the difficult situation in which not a few banks found themselves. The effort, however, had been in vain, and while it might have been possible to bridge over the autumn season had there been a regular means of providing for sudden increases in demand for credit, whether seasonal or permanent, the coming on of a fairly heavy demand for crop-moving accommodation, with withdrawals of funds in large volume from the banks of the cities, brought things to the breaking point. Although in the panic of 1907 and afterward as a result of its effects, a good

many bank failures occurred, they were in most cases not the outcome of bad banking in the ordinary sense, but the result of the overextension of credit in certain quarters and the subsequent development of a "frozen" condition of bank portfolios—as later terminology had it—unaccompanied by any means of liquidation.

It might, indeed, have been possible to bridge over these difficulties had there been no change in the government's power in this matter of furnishing "relief." But shortly before the panic of 1907 developed it had become fairly apparent to most students of the situation that the government's methods of helping out stringency had been exhausted. Secretary Shaw, who preceded Secretary Cortelyou (the latter being in office during the panic), had, as already noted, practically taken up all of the "slack" there was in the government's relation to the banking situation. His substitution of non-national for national bonds in many important capacities, and his facilitation of the issue of bank notes, free of the hampering conditions which for a long time past had tended to prevent such notes from being taken out promptly, were no doubt in their way praiseworthy efforts to facilitate the operations of the banks, but they were certainly disastrous in the long run, in the sense that they used up the last bit of relief power the government possessed without affording any new or amended means of modifying conditions in time of exceptional stringency, or even of meeting heavy seasonal calls for funds.

Dangerous Plans Contemplated

The opening of the panic therefore found the Treasury in an extremely difficult situation—so much so that at one time an issue of Treasury notes amounting practically to greenback currency was contemplated. No such event, fortunately, was allowed to occur and in lieu of so disastrous a means of relief the banks were obliged to content themselves with many forced expedients, practically continuing further the former deposit

and emergency bank note issue schemes which had reached so high a degree of perfection during the Shaw administration. Relaxation of some of the regulations and requirements which ordinarily surrounded the use of government funds or the taking out of new currency tended in a measure to help conditions, but after all only in a limited degree. No student of the panic of 1907 can hold very strongly to the belief that the government in spite of its anxiety to assist did really succeed in improving the financial situation very much. Not only was the total limit of its endeavors a narrow one; but it was also true that the unavoidable obstacles to the performance of government business again deferred and delayed the rendering of assistance even when there was capacity to afford it. As for the government depositories themselves, they were for the most part as badly "tied up" as any other group of banks, and could not have supplied the funds in any other way than as transfers of credit, even had the government been in position to ask them to shift funds to banks which were in difficulties.

Breakdown of Treasury Relief

There is a certain interest in the study of the panic of 1907 from the Treasury standpoint, especially as affording an illustration of the methods of banking assistance then in vogue and as refined by the use of a very considerable degree of ingenuity and skill. Both the Comptroller of the Currency and his chief, the Secretary of the Treasury, were conservative men, each desirous of mitigating the rigors of the panic and both fairly skilled in finance besides being able to command the best banking advice the country could afford. But such advice at its best was not effective in the kind of emergency which had presented itself. The only conclusion which could reasonably be drawn from the experience was that the old Treasury deposit system, like the national bank system of note issue, was at length bankrupt in practice as it had always been in principle. Few of its merits remained, for it had exhausted

its power to relieve or moderate very much the dangers of a stringency or panic; but most of its evils were as serious as ever. Although at the time not much heed was paid to the Treasury aspects of the situation, it was more and more fully accepted by theorists that the Independent Treasury system had practically reached its limit, and that whatever was to be done in banking and currency reform must now include vigorous measures of improvement designed to rectify not only the defects but the real evils of an obsolete method of handling public money; a view already accepted in the abstract but never much insisted on in practical discussions.

View of Bankers

This perception gradually came also to the banking and financial community and in that relation was of crucial significance. The belief that it was desirable to have a friend in the government in need who would at times take a hand in such financial difficulties as might present themselves and that it was not necessary to have reserve or central banking so long as the government, through its Treasury, was prepared to play at intervals the part of a central bank had been very widely diffused. We have seen that it had found an advocate in Secretary of the Treasury Shaw, but it was also entertained by skilled and experienced bankers whose knowledge of finance should have warned them against the acceptance of any such notions. As time had gone on the Independent Treasury system had become deeply rooted in our financial system and the practice of making large operations upon the outstanding bonded indebtedness under conditions which tended to necessitate very close relations between the Treasury and a few of the large banks had come to be accepted as a necessity. There were, it is true, a few who recognized at least the potential evils of such relationships and had long inveighed against them, just as they had deplored the growth of the extensive system of "pet banks" which had come to play so large a part

in American politics. Not, however, until the fact was clearly understood that the Treasury had about reached the end of its resources and that in the future not much could be expected of it, did there seem to be a fair prospect of securing a definite demand for modification of the system, sustained by the financial community.

Contribution of Panic to "Currency" Reform

In one important sense, therefore, it may be said that the panic of 1907, entirely irrespective of the legislation which it produced, laid an important foundation stone for the revision of our banking laws. This was seen in the incorporation into practically all subsequent programs of banking reform of sections calling for the exercise of fiscal agency powers by the banking mechanism provided for in such programs. The Aldrich bill, issued within a few years of the panic under the auspices of the National Monetary Commission, fully recognized this element in the situation and the same was true of other measures which were in process of formulation by private individuals. The Federal Reserve Act took full cognizance of the needs of the case and bestowed upon reserve banks large powers in this regard, although it was handicapped by the modifications to which Treasury officials subjected it with a view to perpetuating, during their own régime, the "pet bank" system; should they be so minded. It required, however, only the demonstration afforded by the panic of 1907 to bring about the general acceptance of Treasury reform as an integral part of the banking reform. When the United States entered the European war in 1917, this necessity became so overwhelming and obvious that it swept away the remnants of the old sub-treasury system and thereby cleared the ground for the necessary relationship which must exist between any sound banking system on the one hand and the financial structure of a government, which involves far greater turnover of cash than any subordinate commercial or industrial enterprise.

CHAPTER III

THE MOVEMENT TOWARD SCIENTIFIC BANKING

Evolution of Banking Reform

It would be difficult to name any given date at which the movement to establish a scientific system of banking first took definite form in the United States, or to designate any individual as very conspicuous in it. In Chapter I it was seen that the earlier so-called "currency reform" agitation was largely superficial. It consisted of propaganda, primarily, and directed its attention to but one phase of scientific treatment, the note issue question, confining itself, under banking influences, very largely to the concept of an emergency note issue, or at best a regularly issued currency jointly guaranteed by the banks of the country. The student who searches through the addresses at bankers' conventions and public meetings where financial issues were discussed during the fifteen years prior to 1913 will find but little in the way of systematic and careful study of the real essentials in banking questions; and very much the same is true of the writings of economic authorities on banking.

American economists had fallen largely into channels of thought which had to do with monetary standards and price theory, and had given only comparatively slender attention to banking practice and organization and to discount and interest theories on their banking side. A review of the various works on money and banking which appeared during the fifteen years after 1890 offers only an occasional element of suggestion. A few authors had from time to time made historical studies of the great foreign banks and banking systems, and there had

been a more or less abundant output of good monographs concerning the early history of banking in the United States and to a lesser extent concerning contemporary banking in Europe. In a few cases, it was stated with more or less explicitness that the central bank plan, although proved by experience in Europe to be fundamental to modern bank organization, had been found inapplicable to American requirements and had accordingly been thrown aside. There were also not a few economists who obviously held to the belief that the introduction of central banking in this country along the lines established by the First and Second Banks of the United States was practically out of the question.

Practical Banking Relief

However, while professional thought on this subject was regrettably barren and sterile, the practical ability of American bankers and business men was finding the way to provide means of correcting the evils produced by the national banking system. As early as 1893, the banks of New York by joint action had provided on a large scale an "emergency currency" or means of relief for hard-pressed institutions which were losing ground owing to lack of public confidence. The clearing house certificate plan, repeated on several successive occasions, had shown the way to united action in emergencies, while the growth of clearing house organization and clearing house systems of mutual examination and oversight had been steady and effective, pointing the way to permanent organization.

After the year 1900, the advance of the city clearing houses in power and authority was such as to command attention. The clearing house in its theoretic aspects had been thoroughly discussed by Professor Charles A. Dunbar as early as 1885, and he had anticipated, though briefly, much later discussion as to the true character and effects of a combined reserve. His early writings show entire recognition of the thought, later too often neglected, that bank reserves may

quite as properly consist of available credit as of cash. After the panic of 1893, and especially during the sporadic banking discussion which followed the Act of 1900, attention became too largely diverted to the technique of clearing and to the detailed functions of clearing houses, but there was a growth of recognition that through mutual or joint organization the banks of the country might become affiliated along working lines without undue surrender of independent functions, and that so organized they might to advantage assume various banking functions long left in abeyance through fear of monopoly or undue competition. This thought, growing as it did out of actual American experience, gained little from European discussion and nothing from the efforts of the few who sought to preach what they termed a "gospel of banking" based on European experience but who lacked the intimate understanding of American banking conditions which might have enabled them to point out practical methods of progress.

Elements of Progress

Actual progress, as it is now easy to see, involved two elements: (1) admission that purely emergency organization for "relief" would not meet the requirements of banking reconstruction; (2) recognition that mere transplanting of foreign central banking methods to American soil, without adaptation to local needs and peculiarities, could never succeed.

From these two basic elements, it was to be inferred that the effective measure of banking advance to be sought would be attained through the creation of an institution or institutions modeled upon European central bank experience, but functioning regularly and drawing their strength and prestige from the support of the combined banking units of the nation, as had the clearing houses of the cities. Concrete advocacy of this view of the needs of the country was, as already remarked, largely lacking, and it was to practical legislators

aided by bankers that such progress as was made in the development of a scientific plan of banking legislation owed its existence. Reference has already been made to the work of Hon. Charles N. Fowler during the years after 1900. Of the details of his proposals more will be said at a later point.¹ They culminated in 1910 in a banking bill based upon the two general requirements already named, which, though followed by other alternative plans, probably represented the best, certainly the most elaborate, piece of work which came from the hands of the chairman of the Banking and Currency Committee. It is worth noting that when, early in 1912, the Banking and Currency sub-committees of the House began work upon what was later to become the Federal Reserve Act (Mr. Fowler having meantime been retired to private life, by the accident of political change), Chairman Glass recalled first of all as the most suggestive piece of work previously done by the Committee this Fowler bill of 1910.

The Mühleman Bill

Meantime, too, work had been done by Maurice F. Mühleman as early as 1909 upon a draft of a measure which practically embodied the essentials already referred to as basic in any reform of American banking. This measure at the time received comparatively little attention, though it was fortunately recorded in published form.² The time indeed was unpropitious for banking theorizing. In Congress during the six or seven years before 1907, nothing more clearly marked out a member as an incompetent dreamer than the advocacy of a banking reform bill; nothing so promptly called forth the taunts of the Bourbons in either chamber as the suggestion that something was needed for the purpose of correcting a bad condition in the monetary system. Even the requests of the Comptrollers of the Currency and the Secretaries of the

¹ See Chapter VII *infra*.

² *Banking Law Journal*.

Treasury for necessary legislation on points of detail were coldly pigeonholed or sharply refused. So utterly hopeless did the situation seem that, as already seen, it even became the fashion with some Secretaries of the Treasury to out-Herod Herod in their allegiance to the situation as it was.

Congress and the Panic

How long the public dissatisfaction which gave rise to the National Monetary Commission or "Aldrich" bill in 1912 and to the Federal Reserve Act in 1913 would have lasted without producing any direct response on the part of Congress had not the panic of 1907 occurred, is an interesting subject of speculation. It is safe to say at all events that the panic in question tended very decidedly to hasten action. True, long before Congress had aroused itself from its lethargy and had undertaken to initiate any measures of reform the panic and its immediate results had passed by. Still it is probably true that without the impetus furnished by the panic of 1907 it would have been impossible to overcome the inertia of Congress. Because of the fact that the so-called Aldrich-Vreeland Law of June 30, 1908, which grew out of the panic of 1907 and was the contribution of the Republican party to monetary and banking thought, contained the provision for the creation of the National Monetary Commission, which led to the establishment of that body, and the eventual formulation of the Aldrich bill, the Act of 1908 has always been ranked much higher than it deserved. The bill in question, however, contained a number of provisions which, in ways entirely unforeseen at the time of their adoption, and in directions very different from what were planned by their framers, strongly influenced events at a later time. Notwithstanding, therefore, that the measure in question has been elaborately discussed in various connections, it is worth while to examine at this point some aspects of the Aldrich-Vreeland Law for the light they throw upon later occurrences.

Origin of Aldrich-Vreeland Law

The Aldrich-Vreeland Law was in many ways a measure of transition from the old to the new in American banking thought. It was the last concrete expression, and hence marked the more or less definite abandonment of, the inadequate notion of emergency currency, or of currency at all, as a means of remedying the banking confusion into which the country had fallen. It also marked the tentative acceptance of the idea of joint organization and self-examination as the real means of bringing about better conditions in the banking life of the United States. And yet the Aldrich-Vreeland Law had a discouraging origin and for a long time bade fair to be of no importance whatever.

As the name implies, the Aldrich-Vreeland Act was based upon two distinct and separate proposals, the one originating in the lower chamber and the other in the upper. Mr. Aldrich, then the dominating figure in the Senate of the United States, at whose beck and call members of both parties held themselves in readiness, had with reluctance undertaken the introduction of new legislation. Yet eventually it became necessary to take some action. President Roosevelt, the "Man of Destiny" in the White House, demanded it and the financial interests of the country insisted upon it. Economists and publicists had long agreed that a measure of reform was necessary, although they had been far from agreeing as to what was desirable. Eventually, Mr. Aldrich recognized action as politically wise if nothing more. Yet to him as a member of the old school in American politics nothing was more nearly anathema than the idea of what was then called "asset currency." Why this should be has often been a subject of wonder. Although Mr. Aldrich was usually considered the mouthpiece of what was even then coming to be known as the "Money Trust," and although the asset currency movement had secured the adherence of many who were currently regarded as closely allied with the "Trust," he had always

opposed it. Perhaps this was largely the result of political association and reminiscence; possibly nothing more than a distrust of "reform" influences. Added to these considerations was the fact that politicians of the older generation had long looked with wonder and approbation upon the national currency system as a means of raising the price of bonds. It was one of those mysterious manifestations of Providence in financial affairs at the time of the Civil War which had often been adverted to with something approaching reverence, and the thought had naturally been aroused in many minds whether this power to raise bond prices could not be invoked in other directions.

Original Senate Proposal

The Aldrich bill, therefore, when originally introduced in the Senate in the spring of 1908 surprised no one in bringing forward a bond-secured currency plan. Mr. Aldrich, indeed, in his principal speech of support definitely committed himself to the thought that it was in some sense a duty on the part of the government to aid in advancing the prices of suitable bonds. The first draft of the bill was built about the central thought that, inasmuch as national bonds no longer needed the powerful support of government recognition as a basis for currency, this support might properly be transferred to bonds issued by the states, cities, and, where possible, the railroads. The latter corporations indeed had found their credit suffering as a result of the attacks of state and federal rate-regulating bodies. If, therefore, a new demand for them could be built up, might not they regain their pristine values and might not the large holders of railroad bonds find themselves possessed of a nest-egg whose worth had been far too greatly underestimated? The original Aldrich bill aimed practically at the direct conversion of miscellaneous bonds into terms of currency by permitting the owners (banks) to deposit such bonds with the Treasury, and to take out on them as security emer-

agency notes which they were at liberty to use as they saw fit. It would have been possible, by continuing the rake's progress of overcapitalization, issue of bonds, underwriting of the securities, depositing the securities with the government, and getting out currency thereon, to open an unprecedented era of overtrading and corporate graft. This bill was promptly "railroaded" through the Senate Finance Committee, and was supported on the floor of the Senate by its author in a speech in which he represented the necessity of getting a market for bonds in general—a market which, he asserted, could be secured by the adoption of his bill. The Aldrich bill, therefore, in proposing the use of non-national bonds as a protection for currency, broadened the base which had been found so narrow during the panic of 1907, but retained the principle of a secured note issue, dependent for its amount upon the volume of various kinds of investment securities which were available in the market. The fact that this kind of currency had no relation to business needs, and was not calculated to adjust itself in any way to demands or prices or rates, was pushed aside as of no importance, and by sheer force the Aldrich measure was driven through a Senate whose members were but little interested in currency and in no way minded to exert themselves against the powerful representatives of finance.

Fowler Proposal Defeated

Yet while this condition was developing in the upper house of Congress, a losing fight had been carried on in the lower chamber with a view to bringing about the adoption of a measure calculated to introduce the principle of a banking currency based upon and protected by commercial paper.

The situation at the opening of Congress in December, 1907, was at once more favorable and more hopeless than had existed for a long time. There was an undoubted popular demand for action. The panic and the accompanying business and banking failures had concentrated attention on the cur-

rency question, so that what had been a matter of indifference was now the topic of foremost interest in the public mind. At the same time, members of Congress were pressing forward with banking plans. Many of these were of an unpractical character, representing in some cases the fads and hobbies of their authors, and in others the work of one-ideaed constituents who were insisting upon recognition for their favorite projects in Congress. Hardly had Congress opened when there appeared a long array of bills relating to banking. The Banking and Currency Committee of the House and the Finance Committee of the Senate found themselves fairly overwhelmed with measures demanding consideration. So great was the number of these measures that probably only a very small percentage, if any, of them, ever received real study from the committees to which they were referred. The chairmen of the committees, however, at once began the task of developing their own plans, and out of this effort appeared the so-called Fowler bill in the House and the rival Aldrich bill in the Senate.

Chairman Charles N. Fowler of New Jersey had, as already noted, been at the head of the Banking and Currency Committee of the House for a number of years and had put before Congress many bills designed to improve the currency and eventually the banking organization of the United States. He did not hesitate to urge to the front a general measure designed to provide an asset-secured currency, and was succeeding so well in his effort to obtain the assent of a majority of the House that the old-line politicians promptly took alarm and determined to circumvent him. To this end they, as in 1900, eventually referred the whole question of currency legislation to a caucus of the party, thereby taking it directly out of the hands of Mr. Fowler and his committee, and so placing it under the jurisdiction of selected agents of their own choosing. Of these Congressman Vreeland of New York was the chief, and so became chairman of the Caucus Committee.

The Vreeland Substitute

The machinery for legislation having been provided, nothing was lacking save ideas, yet even in the House of Representatives the adoption of a bond promotion scheme analogous to that which had rooted itself in the Senate was distasteful. Even more distasteful was the notion of accepting anything from the reformers or "agitators" who had made matters so uncomfortable for the leaders, and who were supporting, at least in principle, the plans of Chairman Fowler. In these circumstances, the politicians were practically driven to the old familiar device of appropriating the ideas of those whom they criticized, adopting them in new language and claiming credit for them. Study of the various Fowler plans, weakened as these were by the variations, and perhaps in some cases, the vagaries, which had found a place in them, showed a consistent thought running all through the various measures. This was the germ idea of all subsequent banking and currency reform and in consequence deserves very careful study. That idea was the concept of co-operative organization of existing banks for the purpose of providing a jointly guaranteed or secured type of credit representative which could be used as reserve funds. The idea was logical, because of the fact that it rested upon the evolutionary institution which had been developed in American financial life as a result of necessity. Organized in clearing house associations, the bankers of the country had shown the entire possibility of joint selection of assets, joint guarantee of the currency or credit based thereon, and joint agreement to regard such currency or credit as a substitute for cash. It was the indigenous American contribution to banking practice or theory, and subsequent success in acclimatizing exotic ideas of central banking in this country was in fact almost dependent upon the skill shown in grafting these notions upon the stem of the native banking organization. Failures were the outcome of refusal to recognize the character of the parent stock.

Conversion of Vreeland Group

Mr. Vreeland and his political superiors therefore obeyed a right instinct when they determined to accept the idea of co-operative banking organization for the purpose of furnishing a basis for the issue of note currency. This notion was taken directly from the Fowler measures, but it was seriously lacking in the fact that those who appropriated it failed to understand the full meaning of what they were doing, while they erred in detail through inexperience and lack of practical knowledge. In the attempt to get the Vreeland bill into practical shape changes in its form were made by the caucus, and by the committee at work upon it, almost daily over a considerable period. In this process the original Fowler notion of co-operative banking organization unavoidably became subject to much modification. The concept of emergency banking was reintroduced into the measure, although provision was made for permanent organizations whose members should be inactive except at times when a sudden and unexpected necessity compelled them to apply for notes. As thus developed, therefore, the Vreeland bill must be regarded as both good and bad—good because it accepted the essential notion of co-operative bank organization, bad because it limited this organization's activity to note issue, and confined it to sporadic or emergency requirements. The root idea of the Vreeland measure was thus quite thoroughly covered over with unnecessary or positively harmful provisions of one sort or another.

Opposition of Leaders

Even in this emasculated form, the Vreeland plan, providing as it did for note currency based upon clearing house principles—that is to say, for the use of commercial paper as a protection for notes—was obnoxious to the old-line political leaders, particularly in the Senate. The fact that the House of Representatives had the courage to adopt it at all, instead of waiting humbly for the edict governing their conduct to come

from the Senate "steering committee," bore eloquent tribute to the unrest which had begun to develop itself in the party as against the Bourbon leaders whose unpopularity was already so widespread. The House, however, was manifestly determined to adopt legislation of the kind which had been developed in its interest rather than to accept a measure ready-made from the upper chamber. As soon, therefore, as the Aldrich measure had been completely developed, it was taken in hand by the controlling clique in the lower chamber and was pushed through to adoption in substantially the form in which it had been recommended by the caucus, the vote in the latter body being 128 to 16.

Legislative Origin

The House bill was introduced on the 13th of May, 1908, by Mr. Vreeland,³ and referred to the Committee on Banking and Currency. Discussion began on the next day. Mr. Vreeland offered a resolution, finally adopted, to the effect that the Committee on Banking and Currency should be discharged and that the House should proceed with the consideration of the bill; that it should be in order, however, to offer as substitute the Williams bill which had been proposed by the Democrats. On the conclusion of debate which was to end not later than 5 P. M. on the same day, a vote was to be taken first on the substitute and then upon the passage of the bill. In introducing this resolution Mr. Vreeland referred to the message of the President of the United States, in which the President had recommended the adoption of a banking and currency bill and in which he also urged upon Congress that a commission be appointed to take up the whole question of banking and currency.

In response to that message we present here today a measure carrying out the recommendation of the President that we shall amend our banking laws, that we shall provide for an

³ H. R. 21871

emergency currency, and that we shall appoint a commission to report at another Congress upon the whole subject and the whole system.⁴

Objections offered by the Democrats were brought out by Messrs. Prince and Williams. They rested upon the ground that the bill:⁵

. . . is an abomination and a miserable makeshift. It ought to be called a bill of "authorization for clearing-house associations of national banks which have violated the law," or a "bill of indemnity for Secretaries of the Treasury who have suspended the operation of the law in behalf of the national banks and clearing-house associations."

Mr. Overstreet on behalf of the Republicans took it upon himself to explain its provisions.⁶ He referred to the panic of the previous autumn, the like of which, he said, would not probably happen again, although he admitted predictions as to the recurrence of like conditions could not be depended upon. The necessity for an increased volume of currency at the crop-moving period of each year was quite apparent. He said:

The emergency currency authorized by this bill and the plans for its issue will, in the judgment of many, be a preventive against such disturbance to business, even though we may not be able to prevent the conditions arising similar to those which arose last fall.⁷

It was for the latter reason that a commission was to be appointed, clothed with the powers of investigation, to report to Congress at a later date the advisability of a change or a revision of the banking and currency laws.

If it should appear by experience that there was no need for a provision for an emergency currency, although we had made by this bill such provision, there would be ample time in which the Committee should make a report and no harm done.⁸

⁴ Record, Vol. 42, Part 7, p. 6245.

⁵ *Ibid.*, p. 6247.

⁶ *Ibid.*, p. 6250.

⁷ *Ibid.*, p. 6251.

⁸ *Ibid.*, p. 6251.

Currency Associations

The bill, as Mr. Overstreet sought to show, provided for a machinery whereby not less than ten national banks with a capital and surplus together of not less than \$5,000,000, could voluntarily associate themselves in a corporate body, through which association they could authorize the issue by any one of the banks belonging to the association of a currency not based upon government bonds. For the purpose of obtaining such additional circulation, any member bank having circulating notes outstanding secured by government bonds to an amount not less than 40 per cent of its capital stock and with an unimpaired capital and a surplus of not less than 20 per cent could deposit with the association in trust such of the securities as would be satisfactory to the board of the association. The board consequently was to apply to the Comptroller of the Currency and ask for an issue upon these securities, and the Comptroller, after satisfying himself that the requirements of the law had been complied with, was to report the application to the Secretary of the Treasury.

The Secretary of the Treasury then finds, first, that a condition of emergency for additional money exists in the State in which that particular bank has its home, and second, that the securities offered are ample to safeguard the Government against loss, and then only 75 per cent of the cash value of the securities offered is permitted to be issued in emergency currency.*

A reserve of gold or lawful money equal to 25 per cent of the issue was required to be held by the receiving bank and as penalty against inflation a tax was to be imposed by the government, 4 per cent for the first 60 days, a further 2 per cent for each 60 days additional, until 10 per cent was reached, and thereafter 10 per cent.

In my opinion, if a mistake is made with reference to these limitations and burdens, it is that they are too severe

* *Ibid.*, p. 6251.

upon the banks. The doubt, however, has been resolved in this instance against the banks and in favor of the business of the country.¹⁰

Safety of Currency

In regard to the safety of the new currency, Mr. Overstreet pointed to the provision according to which the banks were to be jointly and severally liable for the new issue. Furthermore, the collateral filed was to be worth 25 per cent more in cash value than the amount of the notes authorized for issue, and besides, the securities offered were to be submitted to the scrutiny of the executive board of the association.

Such supervision and scrutiny would doubtless result in safer methods of banking, better collateral in the case of the individual banks and consequently a better credit to the entire association.¹¹

Elasticity in the new circulation would be brought about through automatic contraction whenever the emergency currency was returned to the Treasury or an amount of lawful money equal to the issue was paid in.

Ollie M. James¹² attacked the proposed legislation on the ground that it lodged too great a power in the hands of the Secretary of the Treasury—"absolute and undeniable control of the issuance of \$500,000,000 of currency"—and that it provided for an asset currency, basing it upon any security the Secretary of the Treasury might see fit to accept. He said:

I maintain, Mr. Speaker, that under the Constitution of our Government we have no more right to farm out to the national banks, or any other corporation, the right to issue money than we have to give them the right to levy taxes or declare war. One is as much a function of sovereignty as the other.¹³

Mr. James also urged that instead of providing better

¹⁰ *Ibid.*

¹¹ *Ibid.* p. 6254.

¹² *Ibid.* p. 6253.

¹³ *Ibid.* p. 6254.

protection for the depositors, deposits would merely be somewhat less secure in consequence of the new legislation, in allowing the banks to take their securities and pledge them to the government to protect the emergency currency. The provision of the bill according to which the Secretary of the Treasury would be vested with the power to loan out public moneys at the rate of 1 per cent interest, was not defensible, in his opinion, since the old practice of favoritism was simply continued by this provision, instead of getting rid of it by providing that this money should be lent out to the highest bidder. Mr. James finally doubted very much the expediency of a new commission, the proposal for which he considered but a subterfuge to tide the Republican party over the election.

Use of Funds for Speculation

Mr. Pujo¹⁴ characterized the bill as a crude piece of legislation, altogether unnecessary. It would bring about a condition such that all the currency would naturally flow to the eastern banking centers, where it would merely be invested in speculation.

I want to emphasize this fact, that if the law could be amended, and it is the only legislation needed at this session, so as to require banks to maintain the reserves in their vaults and so as to permit the retirement of circulation without limitation, with the consent of the Secretary of the Treasury, there would be no need of legislation of this character.

Mr. Pujo, moreover, offered criticism of the bill reported by the Banking and Currency Committee, the Fowler bill already referred to, which in his opinion was even more dangerous to the business conditions of the country than the Vreeland bill.

Mr. Weeks¹⁵ reviewed the panic situation of 1908 and the relief afforded by the issuance of clearing house certificates, a fact which then and already several times previously had

¹⁴ *Ibid.*, p. 6256.

¹⁵ *Ibid.*, p. 6261.

helped to restore the needed confidence. In speaking of the Fowler bill, which would have revolutionized the entire currency system, Mr. Weeks argued that it should commend itself to the consideration of Congress with but few changes. The Aldrich bill, on the other hand, which would have been essentially a further development of the existing banking laws, while it would have also provided for an emergency currency would not have based it upon commercial paper.

It continues a system which ought to be changed when a better one can be provided, for it requires banks to carry among their assets securities in which they should not in normal times invest their funds and which, generally speaking, they would not carry if they did not need them to provide a basis for additional circulation.¹⁶

Views of Mr. Weeks

In preparing the Vreeland bill, Mr. Weeks explained, the following points were kept in mind: (1) that the currency now is adequate to normal needs, and that therefore there should be no permanent addition but only a temporary increment; (2) that if an addition is made, it should take such a form that it should not be readily distinguished from money now actually in use; (3) that the currency should be issued in the locality where needed without any delay whatsoever, since panics come on suddenly; and (4) that the currency should be so taxed that it would automatically contract as soon as the demand for it ceased. All these conditions, Mr. Weeks argued, were adhered to in the Vreeland bill. Regarding the safety of the clearing house certificates, which could be compared to the new currency, Mr. Weeks pointed to the fact that there was not a single instance where these certificates had not been promptly paid. In concluding, Mr. Weeks reported the indorsement of the legislation by prominent bankers, such as Hon. A. B. Hepburn, the president of the Chase National Bank, a former Comptroller of the Currency.

¹⁶ *Ibid.*, p. 626a.

Republican Opposition

One of the reasons which Mr. Hill (Republican)¹⁷ enumerated against the legislation was that the high tax upon this currency would be distributed over commercial discounts and hamper and restrict legitimate commerce. Mr. Fowler's arguments against the bill were as follows:¹⁸ (1) that there was no need for legislation at the time; (2) that to authorize a bank note circulation without at the same time providing for automatic redemption was an economic blunder; (3) that a properly constituted currency would not allow the concept of an emergency currency, since it would prevent any form of emergency arising; (4) that the distribution of the currency would be unequal, thus doing injustice to the country districts; (5) that the segregation of the best assets of the bank and a prior lien given on them to the noteholder meant the sacrifice of the depositors' interest; and (6) that such legislation would only add to the burden of redeeming the \$700,000,000 of bank notes already resting upon the government, an additional burden of \$500,000,000. Mr. Fowler defended in general the work of the Committee and reminded Congress that all great legislation in every country had been prepared in committees. But he expressed his satisfaction that through much educational campaigning the "Vreeland cohorts" had at least been compelled to accept commercial paper as the basis for circulation.

. . . We have compelled them to treat deposits precisely as note issues, by providing for reserves against bank-note issues the same as we have against deposits.¹⁹

Mr. Kiefer did not think that the Vreeland bill had any relation to proper banking but maintained that it related merely ". . . to a method of escaping the necessary penalties of vicious or illegal banking at great money centers."²⁰ He

¹⁷ *Ibid.*, p. 6265.

¹⁸ *Ibid.*, p. 6269.

¹⁹ *Ibid.*

²⁰ *Ibid.*, p. 6278.

asserted that the so-designed "clearing house associations" had no possible element of a clearing house vested in them. There was no clearing provided for. The new corporate association was to have the right to sue and to be sued, and yet it was at no time to have a dollar of assets in its own right; no provision was made for appointment of the executive committee.

Such associations are required to redeem the additional currency but it has no assets of its own to redeem anything with. And the association could not, as such, be held liable for any defalcations or embezzlements of its officers or agents. What an association to be relied on to create confidence in the presence of financial disaster!

The theory of the bill, as Mr. Kiefer went on to show, was to meet an emergency, but nothing in this bill disclosed what the emergency was required to be. Of the about 6,700 national banks in existence, it would not be possible for one-tenth to form such an association, since they could not fulfil the capital requirements. He concluded:

Bad legislation will not avert or cure another such financial panic; it may promote it. Let us legislate to eradicate the cause of a panic and not alone to try and cure it when it comes. To do the latter is to invite a panic and disaster.

Views on Central Banking

Of the several other opponents of the bill, Mr. Sulzer of New York²¹ recommended a central bank as the only safe method to insure the right kind of banking system. Mr. Goulden repeated the argument that too much power was given to the Secretary of the Treasury and declared the measure hastily drawn up.

When such distinguished Republicans as ex-Speaker Kiefer of Ohio, Mr. Hill of Connecticut, Mr. Prince of Illinois and Mr. Fowler, the able chairman of the Committee on Banking and Currency of the House of Representatives, all men of ability in the financial world, are all speaking against the measure, it seems a safe policy to oppose the bill.²²

²¹ *Ibid.*, p. 6281.

²² *Ibid.*, p. 6283.

Mr. Vreeland himself pointed to the impossibility of a radical change of the banking system at the moment, urging the conclusion that nothing else was left to do but to add additional legislation to that already existing, so that in times of panic a great reservoir might be created which could be instantly drawn upon. He referred to the German system under which in times of financial stress the legal limit of notes could be exceeded with the permission of the government and by paying a tax of 5 per cent. The suspension of the Bank Act in England amounted, in Mr. Vreeland's opinion, merely to a secondary reserve which could be relied upon in times of need. He explained the clearing house principle as applied to the new legislation and concluded:

It will not prevent banks which are mismanaged or which are looted by their officers from failing, but it will prevent the fright growing out of the closing of this class of banks from extending into panic and runs upon other banks.

The final vote on the bill stood 185 against 145, with 51 not voting.

Origin of the Aldrich Bill²³

Mr. Aldrich had introduced his bill some months earlier, offering it on January 7, when it was referred to the Committee on Banking and Currency. It was reported back on January 30 with amendments, when it was placed on the calendar. Mr. Aldrich addressed the Senate at length in reference to his bill on February 10.²⁴ In referring to the previous panic and the methods of relief which were used to alleviate it, Mr. Aldrich expressed the opinion that similar relief measures could not be employed in the case of another panic, because the Treasury was not in a position to make increased deposits in national banks and because a very large proportion of available bonds were already taken up. The

²³ S. 3023.

²⁴ Record, Vol. 42, p. 1755

United States furthermore might not be able to command large importations of gold.

There seems to be but one way in which this can be accomplished, namely, by some provision for the authorization of additional notes to be used only in emergency.²⁵

He continued explaining the action of the Committee, which after thorough consideration had decided to be guided by the experience of the great commercial nations. The Committee believed the example of Germany the safest precedent to follow and the one most likely to answer present needs successfully.

The measure provided for a possible emergency issue of \$500,000,000 of national bank notes to be redeemable by the Treasury. They were to be identical in character and tenor with the ordinary national bank notes and were to be issued to any association by the Secretary of the Treasury, if business conditions in any particular locality demanded additional circulation. The banks were required to deposit with the Treasury municipal or first-class railroad bonds, of a character and in amount satisfactory to the Secretary. These notes were to be distributed equitably among banking associations and were to be subject to tax at $\frac{1}{2}$ per cent monthly or 6 per cent per annum.

The remedy we provide is simple, prompt and efficient. At any time within 48 hours, if an emergency requires it, \$500,000,000 of new money can be put into the channels of trade to allay public excitement and to meet extraordinary demands.²⁶

Source of Bonds

As to the criticism that banks did not have or carry the securities to be accepted under this bill, Mr. Aldrich pointed to the benefits that would, he saw, accrue to the states and

²⁵ *Ibid.*, p. 1756.

²⁶ *Ibid.*, p. 1757.

municipalities which are in constant need of local improvements. And in regard to the criticism against the use of railroad securities:

The Committee recommend the use of first-class railroad bonds because they are the only securities, outside of State and municipal bonds, issued by corporations whose public records, showing conditions and earnings, as now provided by law, would enable the Secretary of the Treasury to definitely ascertain the value and the safety of the security. In theory and by existing legislation railroad companies are quasi public corporations and under strict government control and regulation.²⁷

In answering all other criticisms, which had been offered against the kind of security to be accepted behind the emergency currency, Mr. Aldrich pointed out that, if all the national banks should hold the entire amount of bonds necessary behind an issue of \$500,000,000, it would mean the investment of but little more than 6 per cent of the total resources of such banks. To the critics who wanted a revolutionary change of the entire banking system, Mr. Aldrich answered:

Whenever a monetary system has been adopted or adjusted to meet the business and customs of a people, it should not be changed in haste, because theorists disapprove, or bank managers, for selfish interests, declaim against it.²⁸

In concluding, Mr. Aldrich expressed his belief that there could be no reasonable doubt of the effectiveness of the measure.

Discussion of the bill extended over several days. Mr. Owen, speaking as a Democrat,²⁹ heartily approved the measure because it provided for "emergency notes, secured by bonds, under a penalty higher than the normal rate of interest." He objected, however, that the emergency issues were to be national bank notes in form, thus requiring 6,600 varie-

²⁷ *Ibid.*, p. 1759.

²⁸ *Ibid.*, p. 1760.

²⁹ *Ibid.*, p. 2428.

ties to be printed notwithstanding they were really Treasury notes, payable in gold or its equivalent. He also protested against the rigid limitations under which alone national banks could take out this currency, they being prohibited from doing so unless an amount of notes equal to 50 per cent of their capital was already outstanding and unless their surplus was more than 20 per cent, while not even then could a bank under any circumstances take out more than an amount equal to its capital and surplus. He furthermore criticized the measure because it excluded state banks and trust companies from its benefits. He was against railroad bonds on account of their wide fluctuations.

Senate Amendments

Protracted speeches on the Aldrich measure were offered during February and March. Various senators advocated either a central bank or a guaranty fund or (like Mr. Newlands) better legislation for state banks. The reserve question was discussed and a provision recommended and supported by many that national banks should keep their reserves in their own vaults. Mr. Owen offered a substitute amendment including provision that national banks should be forbidden to invest their funds for speculative purposes. The strongest objection, however, was raised against railroad bonds as securities behind the emergency notes for the reason of their wide fluctuations and because this would put a premium on railroad over other securities.

It was in view of this discussion that the Committee on Finance decided upon some amendments which it offered on March 17th and which were consequently adopted. The first amendment provided that no notes should be issued upon any securities in excess of the par value of the bonds deposited. The second restored the \$9,000,000 limitation on the monthly retirement of notes based upon United States bonds, a provision

²⁰ *Ibid.*, p. 3421.

which was favored by many. The third amendment struck from the bill all provisions pertaining to railroad bonds.

The Committee believed when the bill was reported and they now believe, that it would be desirable to have for use as a basis for these emergency notes as large an amount as possible of available securities. But the Committee find that questions are raised in regard to the use of railroad bonds which have no reference to the bill now under consideration—questions of the relation between the railroad and the public and as to the proper regulations of railroads and of the issue of railroad stocks and bonds. Under all these circumstances the Committee have thought it better to ask the Senate to strike out the provisions which pertain to railroad bonds.⁸¹

An important amendment by Mr. Johnson changed the reserve requirement of country banks so as to read that four-fifths of the 15 per cent reserves were to be kept in the banks' own vaults. One-third of the reserves could be kept in such securities as were required for the emergency currency. The effect of the amendment would have been to withdraw about 6 per cent of the reserves, which up to then were allowed to be kept with reserve agents. Another amendment offered by Mr. Nelson, which was likewise adopted, provided for a similar reserve requirement for reserve city banks. Mr. LaFollette's one amendment which forbade the loaning of banks to their own officers was accepted; not so, however, his provision which sought to stop the practice of interlocking directorates.

The bill was adopted as amended on March 27, 1908.

The Conference Discussion

When the House had finally adopted the Vreeland bill and had sent it to the Senate, further discussion in that body was of little significance or importance. The Senate bill was reported by the Senate Committee on Banking and Currency on the 15th of May, as a substitute for the House bill. It was the original Aldrich measure as adopted with some slight amend-

⁸¹ *Ibid.*, p. 3421.

ments but omitting the extensive changes made on the floor. The minority on the Committee had unanimously agreed to report the bill and to ask for prompt action in order to get the measure into conference, Mr. Money, however, explaining that although he voted to substitute it for the Vreeland bill, because he thought the latter inferior to the Aldrich bill, he would go on record as against the Aldrich bill, when it came to a final vote. Mr. Culberson thought the amended Aldrich bill far more objectionable than the original. Mr. Newlands agreed to the clearing house principle in the Vreeland bill but wanted it extended so as to include as members also state banks, which would have to be compelled to come up to the same requirements in regard to capital and reserves as the national banks.

The Senate insisted upon its amendment and asked for a conference. In the House on the same day, Messrs. Williams and Fowler expressed their indignation at the speed with which the legislation had been hurried through by the Republican machinery, declaring that the measure was infinitely worse than the House bill.

This measure is worse even than the Aldrich bill, because it strikes out of the Aldrich bill the feature to provide a penalty against dishonesty—the La Follette amendment, which was a good feature in it. It strikes out of the Aldrich bill the Johnston amendment to force the banks to keep a certain percentage of their reserves in their own vaults, which was a good feature in the Aldrich bill.³³

Mr. Burton thereupon moved to disagree with the Senate and sustain the Vreeland bill and to call for a conference. His motion was adopted.³⁴

Final Form of Bill

The conference report as laid before the House on May 27³⁴ was explained by Mr. Vreeland to be the original House bill with some parts of the Senate bill in addition.

³³ *Ibid.*, p. 6372.

³⁴ *Ibid.*, p. 6376.

³⁴ *Ibid.*, p. 7063.

To that bill we have added the provision of the Senate bill which permits any bank in time of emergency with the consent of the Secretary of the Treasury to deposit public securities—that is, State, county, municipal, and district bonds—with the Treasury Department and circulation up to 90 per cent may be taken out against it. But it is evident that when this provision is incorporated in the House bill all of the criticism which would lie against the Senate bill standing alone falls to the ground.²⁶

Such criticism had been voiced by bankers all over the country, who, in order to avail themselves of the provision of the Senate bill, would have been obliged to buy \$400,000,000 or \$450,000,000 of these particular bonds which had been required to be kept as security against the emergency currency under the Aldrich bill. Banks which did not happen to own municipal or other like bonds were to be given every facility by the conference bill to obtain circulation upon securities which they did own, by joining a currency association.

That portion of the bill which provided that the same reserve should be kept against these emergency notes as against deposits was changed and a provision adopted according to which banks taking out emergency currency should keep a redemption fund of 10 per cent with the Treasury of the United States. The rate of taxation was altered so as to commence at 5 per cent and to increase at the rate of 1 per cent a month until it reached 10 per cent, at which limit it was to remain as long as the circulation would stay out. The commercial paper was to be two-name and not to run longer than four months. Not to exceed 30 per cent of the capital and surplus of the bank should be issued against commercial paper alone. The provision that every state was entitled to the notes apportioned to it out of this \$500,000,000 circulation was retained. Mr. Vreeland remarked:

I want to say that the Senate provision harmonizes perfectly with the House provision in this bill. There is no con-

²⁶ *Ibid*, p 7066

flict between them whatever. It makes a broader base for this legislation. It gives banks which desire to purchase and hold public bonds the right to take out circulation direct. It gives those who do not wish to buy and hold these class of bonds the right to use the legal securities in their banks through these associations.⁸⁶

As to the criticism that the bill was not safeguarding the interest of the depositor, Mr. Vreeland pointed out that the object and purpose of this bill was solely for the benefit of the depositors. It was to enable banks to pay their depositors upon demand, in order to prevent such a suspension of payment as took place on previous occasions.

Mr. Pujo⁸⁷ congratulated the Republican party upon its adoption of the asset currency idea. Mr. Glass predicted that not a single great bank in America, capable of taking care of itself in times of financial stress, would be induced to join a currency association as provided for in the Vreeland clause for the purpose of getting emergency currency. "The country will have to be in an unhappy state, indeed, to cause the formation of such associations." He also argued that there was no likelihood of any emergency, but should there be a disturbance in the coming autumn, as had been hinted, no relief could possibly come from the bill for the reason that about two years would be required by the Treasury Department to get fully prepared for the issue of these new notes.

Ollie James reproached the conference for having reduced the reserve to a redemption fund of 10 per cent and for not having adopted such safeguards as denying directors the right to loan to each other depositors' money.

Mr. Williams concluded his criticism of the bill by referring to the fact that but few days ago the Senate had denounced the Vreeland plan as iniquitous and destructive of the best interests of the country and that the House, on the other hand, had declared the Aldrich bill as "altogether wicked."

⁸⁶ *Ibid.*, p. 7068.

⁸⁷ *Ibid.*, p. 7068.

But today the great discovery—two iniquities compose a perfect good. Neither bill was good enough for either House, but today both bills combined are good enough for both Houses.

Both Mr. Weeks and Mr. Burton, the latter being the last speaker, pointed to the fact that the measure was not intended to be a permanent law, but that a time limit of 6 years had been inserted in the bill, it being expected either that by that time the Commission would have reported in favor of new legislation or that experience would recommend prolongation of what had been created by this measure.

The conference report was adopted by a vote of 166 yeas against 144 nays.³⁸

The consideration of the conference bill in the Senate met with obstruction and it was not before the third day of debate that a vote could be taken. Debate was closed on the 30th of May. Mr. Aldrich in his introductory speech confined himself to a short explanation of the new features that had been adopted, namely Sections 1 and 2, containing the Vreeland provision for currency associations, which provision in effect constituted an alternative plan to the Senate bill.

The critics of the bill in extended speeches urged arguments similar to those which had been heard in the House, chiefly the argument that the Senate would act inconsistently if it now adopted a provision which it had flatly rejected on former occasions. The smaller banks were given no fair chance and there was really no need for legislation. Mr. Owen again urged that the notes ought to be the direct notes of the United States Treasury and not of the various national banks, of which there were over 6,000 in existence, which meant that about 6,000 different kinds of notes, each differing in form from the others, although substantially alike, had to be provided for. He also pointed to the fact that no adequate remedy was provided for the relief of the state banks, which had two-

³⁸ *Ibid.*, p. 7077.

thirds of all the banking power in the United States, an argument still more extensively developed by Mr. Newlands,³⁹ who again demonstrated the inadequacy of the reserve provisions as regards the state banks.

I protest against this system of legislating for only one-third of the banking system of the country. I protest against this system which perfects only the national banks of the country and absolutely ignores the great power of the union of the States to require security and safety from the State banks themselves in the interest of the general business of the country and of commerce, interstate and foreign.⁴⁰

Effect of Law of 1908

The adoption of the Aldrich-Vreeland Law was not followed by any immediate progress in the organization of the national currency associations for which it provided. Difficulties shortly appeared growing out of the fact that the terms of the legislation were too loose to permit of effective organization under it. Eventually a good many currency organizations were formed, but only under the urgency of war conditions and as a result of amendments introduced by Congress into the original legislation. The law soon came to be recognized by the more advanced bankers in the community, as well as by banking and currency theorists, as merely an experimental step. It was not satisfactory to any element in the community and as the defective character of its language came to be better and better understood, there was an increasing demand for something of a more thoroughgoing nature.

The appointment of the National Monetary Commission, for which provision had been made in the act itself, in a sense tended to check further discussion pending the time when the Commission should make a final report. Nevertheless not a few bankers as well as students of the currency and banking questions continued to concern themselves with discussion of

³⁹ *Ibid.*, p. 7113.

⁴⁰ *Ibid.*, p. 7116.

the lines along which reform legislation would have to proceed. During the years 1908-1911 there may be traced in a variety of quarters the beginnings of a definite recognition that the old style of currency reform was now practically out of date and that it would be necessary to develop a very much more extensive and thorough kind of legislation if any effective results were expected. During these years there may be noted also a decided spread of the central bank philosophy, due to a belief that what had been done with success in Europe would eventually have to be done in the United States. Some, it is true, still clung to the idea of a closer imitation of the Canadian banking system, but even these began to recognize that the great merit of the Canadian banking system did not lie exclusively in its flexible note issue but was found in its branch bank plan. The introduction of branch banking into the United States was regarded as politically impossible. In the course of the years in question many large banks resorted to a roundabout method of obtaining the benefits of branch banking through the purchase of smaller banks and trust companies and through the adoption of various methods of tying the stock of such concerns to their own. They were of the opinion that the amendment of the National Banking Act to permit branch banking freely was out of the question, and they therefore sought to get at the same end by indirection, although with the full knowledge and consent of the Comptroller's office in Washington. But this more widespread recognition of the true character of the Canadian system and this increasing tendency to discontinue the undue emphasis which had been placed upon note issue helped, in a decided fashion, to strengthen the central banking movement. As to what kind of central bank to provide for, there was, however, no consensus of opinion.

CHAPTER IV

THE NATIONAL MONETARY COMMISSION

Scope of Work

Much more significant than the actual currency sections was the provision of the Aldrich-Vreeland Act which called for the appointment of a commission to be known as the National Monetary Commission and to consist entirely of members of the Senate and House. This Commission was immediately organized and continued to do sporadic work until March, 1912, when it was dissolved by virtue of an act of Congress passed in the preceding August, just before the close of the special session of Congress summoned by President Taft for the discussion of the reciprocity question.

Persons employed by the National Monetary Commission prepared a large series of books on various historical and current phases of the banking question, but the feature of its work which became politically important is found in a bill drafted under the auspices of the Commission and finally laid before Congress with a brief accompanying report giving the reasons for the measure. This measure was at once introduced into Congress by Senator Theodore E. Burton, himself a member of the Commission, and was referred to the Senate Finance Committee.¹ It at once became an issue between the political parties and gave rise to a formidable "movement" charged to secure its adoption.

The action taken in creating the National Monetary Commission, and in thus permitting it to prepare a bill for use as a basis of legislation, if not to be the actual form of such legis-

¹ S. 4434, 62nd Congress, 2nd Session.

lation, was in line with the system which, as already seen, had been characteristic of Congress during the preceding decade. The plan of having such a bill prepared and placed before Congress by some other than the regular committees intrusted with that duty was thus the lineal successor of the method by which the Gold Standard Law of 1900 was prepared, and by which the House had acted upon the Vreeland Law, but gave rise to some unexpected results.

Inactivity of Commission

The National Monetary Commission was not, it seems fair to say, especially concerned or anxious about the work before it. Congress had regarded the new Commission with customary cynicism and had sought to make it a source of patronage. Senator Aldrich had rejected the idea of having "expert" members of the Commission, plainly expressing his opinion that Congress could "hire" all the experts it wanted, and had confined its membership to members of the House and Senate. Places upon it had been distributed by the leaders without much regard to fitness; and, although the Commission held some hearings, while members of it visited Europe and there collected a series of "interviews"² and other data, it is well established that neither the Commission itself nor its individual members had much direct share in the preparation of what later came to be known as the "Aldrich bill." As to the authorship or origin of this measure many stories, most of them doubtless legendary or apocryphal, have been published by various Boswells. Probably, as with most such pieces of work, it was not the result of any one person's activity. The interesting matter in that connection is not an historical analysis of personalities or personal history but rather the general character of the auspices and influences under which it was prepared.

² Report of National Monetary Commission, S. Doc. 307, 61st Congress, 2d Session.

Origin of Commission Bill

The measure was not the work of Senator Aldrich himself. Mr Aldrich never claimed the specific authorship of it, and curiously enough, said little in support of the measure. He had been for years past known as an opponent both of central banking, "elastic currency," and nearly every other idea embodied in the Monetary Commission's bill. He had, moreover, upon his return from the Commission's visit to Europe in the autumn of 1910, taken a position directly opposed to some of the fundamental notions of the Aldrich measure (later to be prepared and published). At that time he had declared himself deeply impressed with the central banking institutions of Europe and with their methods, and had advocated a central banking institution, modeled somewhat upon European lines, for the United States. This, however, as was later to appear, was anything but acceptable to the leaders of the banking profession in the United States.

Mr. Aldrich's apparent conversion to central banking promptly gave way to the plan which was shortly to be embodied in the Aldrich bill. That measure was prepared during 1911, was laid before President Taft at sessions at the White House attended by representatives of the larger banking institutions, and was eventually approved. Its terms were in some measure kept secret until officially announced by the Commission when they were given to the public in a statement reading as follows:

The National Monetary Commission, composed of sixteen Members of both Houses of Congress, representing both of the great political parties and all sections of the United States, has made a unanimous report in presenting a detailed plan for the reform of our banking and currency system.

This plan has been widely discussed throughout the United States for the past year. As a result of such discussion and criticism many changes have been made in it. No one man nor all the members of the commission may claim credit for this plan of financial reform. It is the composite result of the study and discussion of the past three

years by thousands of men best qualified to consider such a subject. This plan has received the practical endorsement of all the bankers of the United States. It is approved by practically all of the professors of political economy and financial writers. It has been approved by many bodies of business men after a thorough study of its provisions. The practical men and the men of theory have agreed upon this proposed measure. Those who approve and those who oppose this plan are agreed that our banking and currency system is antiquated and dangerous and should be radically reformed.

IMPORTANCE OF BANKING REFORM

It is generally agreed that the reform of our banking and currency system is the most important question before the people of the United States. Why is it so important? Because all other businesses rest upon our banking system and when it breaks down they break down with it. We have had a money panic on an average of about once in ten years for the past half century. It is my opinion that they have brought more losses and suffering to the American people than all the wars in which they have been engaged, barring alone the loss of life and limb. People have almost come to regard money panics as a dispensation of Providence, like earthquakes and cyclones, which we must bear with resignation and from which there is no escape. But in the opinion of economists and financiers, both in this country and abroad, these money panics are entirely unnecessary. If they are preventable is it not almost a crime to permit them to continue to sweep over the country with all the losses and suffering which they bring in their wake?

How can we be sure that they are unnecessary and preventable? Because the great nations across the sea, our competitors for the trade of the world, with their long experience and scientific banking systems, have not had a money panic in from fifty to one hundred years. The great countries abroad no longer have money panics from causes which precipitate them in this country. They have failure of crop and business depressions and wars and rumors of wars much more often than we do, but these conditions abroad no longer result in money panics and runs upon banks. Does anyone doubt that a failure such as that of the Baring Brothers of London in 1892, had it occurred in the United States, would have precipitated a panic? Similar failures have happened in France and Germany but the banking machinery of those countries is such that they were able to withstand the shock.

EFFECT OF PANICS

We are all familiar with the effects of money panics. They involve runs upon solvent banks in different parts of the country, the closing of numbers of banks, general suspension of cash payments by banks, the breaking down of domestic exchange, premium upon cash, calling in of loans so far as possible, stocks thrown upon the exchange at ruinous prices, railroads in the hands of receivers, the closing of factories, hundreds of thousands and sometimes millions of people thrown out of employment and others working at reduced pay, widespread losses and suffering among the people. It usually takes years for confidence to return and for business to regain its former level. High prices are largely attributable to panics because business men feel that they must make the largest profit possible when business is good, to offset the losses of the panic years when they come. American business life has been a succession of feast and famine.

NOT A BANKER'S QUESTION

Banks and bankers are less interested in currency reform than manufacturers or farmers or wage earners. No one will dispute that wage earners suffer more from money panics than bankers when he remembers the millions out of employment following the panic of 1893; and when we remember the prices of farm products during that same period you will concede that farmers are vitally interested in a banking and currency system which will prevent panics.

Until the panic of 1907 the great mass of our people believed that our banking and currency system was well adapted to the business needs of the country. Great panics of preceding years were attributed by the people to other reasons, but in 1907 we had no excuse for a panic except lack of stability in our system and a lack of confidence by the people, and particularly by the bankers themselves, in our system. There was no prospective change in our tariff laws. After a great contest the gold standard had been fixed in our statutes, the silver purchasing act had long been repealed. It was a time of great prosperity; railroads were overwhelmed with freight, factories were filled with orders and our people were fully employed at high wages. To most of our people the panic of 1907 came like a bolt out of a clear sky.

We may admit that there had been over-expansion of business in its relation to available capital, but should our monetary system not be such as to give warning to the people through rising rates of interest? It may be said that the panic was precipitated because speculators had obtained control of some of the great banks of New York City. But

speculators will always exist, and if the bankers of the country and the people have confidence in our banking system, why should the whole country suffer panic because of the acts of a few? If our system will not bear up under its own weight in time of prosperity and peace what would be the result in time of war?

FAULTS OF OUR SYSTEM

The banking and currency systems of all of the great countries of Europe have been revolutionized during the past fifty years. As a result of their longer experience every great commercial country abroad has adopted the principle of centralization of note issue under Government supervision and centralization of cash reserves of banks. During the last fifty years the business of banking in the United States has increased enormously. We have about twenty-five thousand individual banks but our banking laws have remained substantially the same as they were when the National Bank Act was passed during the Civil War. Our bank notes, upon which we should depend for elasticity in the volume of our money, are still issued by a multitude of widely scattered banks, and regardless of the needs of the business. This method has been discarded by every great commercial country abroad, commencing with England in 1884.

The reserves against our fourteen billion of deposits in the banks of the country, are scattered among a multitude of banks with no provision for centralizing them in unlimited amounts wherever and whenever needed. Under our system, the Treasury Department, when it has a large surplus, and half a dozen of the great banks in New York City act as our central banks, but that they are not fitted to perform the functions of the central banks abroad is shown by the fact that they have broken down in every time of severe strain.

HOME-OWNED BANKS ARE BEST

Our system of having thousands of independent banks, owned and managed in each city and town, is one that is satisfactory to the country. Our people would not be satisfied with the branch bank system in use in the great countries abroad, under which a few great banks are located in Paris or London or Berlin and the country is covered with their branches. Doubtless our independent banks, owned in each community, have been a large factor in the development of our country. The trouble with our system is that it breaks down in time of financial stress. It lacks cohesion; there is nothing to bind the thousands of banking units together. The moment financial trouble

approaches tens of thousands of individual banks, instead of uniting their resources to fight the common enemy—distrust and lack of confidence—commence fighting each other for reserve money, urged by the instinct of self-preservation. If a panic starts in New York or Chicago, other cities do not send money to help extinguish it but rather attempt to draw away money which they may have there.

Our system, then, lacks leadership and a method of co-operation between the banks, fixed and regulated by law, under which their mighty resources can be used to ward off panic and distrust.

SYSTEM OF NOTE ISSUE

It is difficult to imagine how our system of note issue could be worse. It is upon the bank note issue that we should depend for elasticity in our volume of money. Under any proper system the volume of money increases as business increases and decreases in the same way. The history of our bank note issue shows that the needs of business have very little to do with the volume of bank notes. During almost every period of expansion in business for more than thirty years our volume of bank notes has decreased. During the periods when business was prostrate, as from 1892 to 1897, the volume of our bank notes was largely increased. This is because the volume of our bank notes depends upon the price of government bonds and not upon the needs of business.

REFORMS NEEDED

Two great reforms, then, are needed in our system. First, a currency based upon gold and commercial paper endorsed by banks, which will be responsive to the needs of business. Its increase and decrease should be automatic. Following the example of the other great nations of the world, this note issue should come from a central organization, under regulation of law.

Second, a mobilization of a part of our cash reserves, say four or five hundred millions of dollars, in the hands of some central organization where it can be used instantly and in overwhelming amounts wherever needed.

These two principles have been adopted by every independent civilized nation in the world except our own, although the method of applying them varies in different countries.

What we must do is to adopt these financial principles and adapt them to the different conditions and needs of the United States. This does not mean that we could set up here the bank of France, or

of England, or of Germany, or the United States bank of Andrew Jackson's time. None of these would be suitable for the conditions prevailing in the United States. Our people are especially afraid lest such an organization, if created, shall fall under the control of great financial interests or become the subject of political contention. It must be absolutely plain to our people that neither of these things can happen and that the paper money issued shall be as good as the present bond secured currency.

THE NATIONAL RESERVE ASSOCIATION

I believe that any intelligent man, who will study and understand the plan of the National Monetary Commission, will admit that it is a plan under which money panics will be impossible, interest rates lower and more uniform, and financial or political control impossible. It embodies the best thought and discussion on the subject of the last three years. The legislative committee of the American Bankers Association, composed of more than twenty prominent bankers representing every section of the United States, after careful study has pronounced the plan fundamentally sound, recommending, however, some changes in its organization. It has been unanimously approved by professors of political economy and financial writers both in this country and in Europe.

MANAGEMENT OF RESERVE ASSOCIATION DE-CENTRALIZED

This plan creates a National Reserve Association located in Washington, with an authorized capital of about three hundred millions of dollars. It can do business only with banks and with the government. Any bank which reaches a fixed standard, state or national, may be a stockholder to the extent of ten per cent of its own capital. The stock is non-transferable and can not be voted by proxy. The Governor is appointed by the President of the United States, from a list of names, however, selected by the directors of the Reserve Association. Under this plan the management is de-centralized. Under this plan, while the note issue and portion of the cash reserves are centralized, the management is de-centralized so that the whole country is equitably represented. Under this plan the country is divided into fifteen districts. The board of directors consists of forty-six members and each one of the fifteen districts elects its own members of the board. Fifteen directors must be selected who shall not be bankers or legislators but who shall fairly represent the industrial, agricultural and commercial interests of the country.

The dividends which the Reserve Association may pay to stockholders are limited to five per cent, the balance of its earnings going into the Treasury of the United States. The Reserve Association may purchase short-time commercial paper but it can not loan upon stocks or bonds nor purchase stocks or bonds, except bonds of the United States.

It may issue bank notes based upon fifty per cent of gold in its vaults and commercial paper endorsed by banks.

The National Reserve Association is exactly opposite in principle to the United States Bank of Andrew Jackson's time. That bank was a great monopoly; it was a money making machine; it existed for the benefit of those who owned it; it was the enemy and competitor of every other bank in existence; it established branches in all cities of the country; there was no limit upon the dividends it might pay; it was simply a great monopoly chartered by law.

The National Reserve Association will be created for the purpose of fighting and preventing monopoly. It will be impossible for it to monopolize because its powers are limited by law. It will have no purpose to monopolize because all of its earnings above five per cent will go into the United States Treasury. If the dividends of the Standard Oil Company could be limited by law to five per cent and the balance of its earnings go into the Treasury of the United States, it is evident that its whole incentive towards monopoly would be destroyed.

KEEP IT OUT OF POLITICS

The reform of our banking and currency system must be kept out of politics. There is no present division between parties upon this subject. It should be studied from a scientific and economic standpoint rather than from the standpoint of partisan politics.

The bankers through their state organizations, the business men through their trade organizations, and intelligent people generally should study the subject, agree upon the plan best suited for all parts of the country and then demand of Congress that it be enacted into law.

Character of Banking Influence

There can be no doubt that the Aldrich bill was prepared under the general influence or supervision of the larger bankers. Members of Congress, both Republican and Democratic, have positively asserted that they had never seen it until shortly

before it was presented to the Commission, approved by it (some members transmitting favorable votes by telegraph without having seen the measure), and quickly ordered given to the public. These facts regarding its history throw light upon its peculiar subsequent experience and fully explain the reason why it never appealed to the public. There was no popular support for, or understanding of it—no body of opinion which could be regarded as demanding or warranting it. The only chance of forcing it through Congress lay in the continuance of supremacy on the part of those who had made themselves responsible for it.

But, strangely enough, just as the ground had been prepared for the adoption of some measure—a measure which, as things have turned out, would completely revolutionize the existing banking system—conditions in Congress suddenly changed. The control of the lower chamber slipped out of the hands of the old-line Republicans and into those of the Democrats, while in the Senate the development of the direct primary system and the general uprising against the methods of boss rule broke down the old personal machine which had been erected by Mr. Aldrich. When the Monetary Commission finally made ready to report, it found the political ground upon which it rested so completely cut away that no sure footing was left. The report of the Commission fell dead upon a House wholly alienated from the personal control, and from the party which had been dominant when the Commission was created; while in the Senate nearly as much hostility to its work was manifested. It was no longer true that masterful leaders in either house could force a bill of their own making upon the legislative branch of the government, nor was it the case that the support of these leaders even afforded any genuine strength to the measure. If anything, such support was a source of weakness. This whole question of the legislation was thus made dependent upon its intrinsic merit and upon the capacity of the machinery pro-

vided in either house for considering and forwarding such a bill.

Provisions of Bill

The outlines of the Monetary Commission measure were at the time of its inception fully discussed and at that time became thoroughly well known to all who had the slightest interest in the general subject. That the bill itself was more carefully worked out, more fully elaborated, had been submitted to and approved by more different groups interested in banking reform than any similar bill theretofore offered for a long time past, there can be no question. That the bill was a startlingly new or especially ingenious proposal nobody would contend. Practically every idea contained in it could be found in bills which had already been offered to the country, while its underlying thought, like that of its predecessors, was founded upon the clearing house experience of the United States. Its novelties lay in features erroneously foisted upon or incorporated into it as the result of regrettable special influence or through misconception of the applications of European experience in the administration of central banking.

But time obscures details and there has sprung up a legendary history or interpretation of the Aldrich measure which calls for correction if contemporary banking problems are to be understood in the light of the past. A brief sketch of the chief elements of the Aldrich or Monetary Commission bill thus becomes essential and will be furnished in the next few pages.

Mr. Aldrich's Argument

The first public announcement of the Aldrich measure was officially made in a communication addressed by Senator Aldrich to the National Monetary Commission itself and entitled "Suggested Plan for Monetary Legislation submitted

to the National Monetary Commission by Hon. Nelson W. Aldrich, Document 784, Senate, 61st Congress, 3rd Session." This bore the date of January 16, 1911. The report of the National Monetary Commission to which reference is usually made was a later document and was dated January 8, 1912. Although some progress occurred between these two dates, the proposal taking form as an actual bill submitted in the latter document, the measure thus formulated followed substantially the lines which had been adopted by Mr. Aldrich in 1911 in his earlier suggestion. The object of the original suggestion, as indicated by Mr. Aldrich, was to "permit the formation of an association of all the banks of the country," designed to end the condition in which there had been developed "a great number of isolated units each working within a limited circle and each of necessity governed by its own immediate interests without reference to what would be for the greatest good of all."

Prior to the publication of Mr. Aldrich's suggestions, there had been a session at the White House at which the general idea of the measure had been discussed with bankers and representatives of citizens' associations, and the proposal practically represented the joint consensus of opinion which had thus been arrived at. As elsewhere noted, the National Monetary Commission itself was probably less "on the inside" in respect to this measure than almost any other group in the country, in so far as it consisted of persons really concerned in the development of banking legislation. The Commission, in fact, had no knowledge, as individual members of it have often stated, of what had been decided by the chairman until the time arrived when publication of the plans agreed upon was near at hand, and when therefore they were submitted to the Commission for an approval which was unanimously given. The actual report of the Commission submitted in 1912 was in fact unanimously signed by all members of the organization.

Combination of Banks

The Aldrich bill thus offered was essentially a plan for a combination designed to embrace all of the banks of the country which might determine to accept membership in it. This combination was to be called the National Reserve Association and its capital was to amount to 20 per cent of the paid-up capital of all eligible member banks. Not less than \$100,000,000 was to be paid in before business could be undertaken and the head office was to be located in Washington. Banks of every kind were to be permitted to subscribe to the stock, provided that state banks and trust companies so subscribing were to comply with the capitalization regulations of national banks in the same places, and otherwise to conform to some of the essential requirements of the National Banking Law. The institution was to have branches, fifteen in number, whose locality was generally described, the entire country being divided into fifteen districts. An organization committee was to group the subscribing banks in each district into local associations and each such association was to have a board of directors partly chosen by the banks of the association itself. Each such local association was to elect a voting representative and these voting representatives were to choose the board of directors of the district branch. The National Reserve Association itself was to have a board of directors of fifteen persons, one chosen by the board of directors of each of the branches, and of fifteen additional directors chosen from among the business men of the district and of nine others to be chosen after a somewhat different method of selection.

Type of Control

A body of seven ex-officio members of the board were to constitute a permanent group regularly operating the reserve association and including in its membership the Secretary of the Treasury, the Secretary of Agriculture, Secretary of Com-

merce and Labor, and the Comptroller of the Currency. One of these seven was to be the governor of the reserve association and two others deputy governors. Provision was made for the election of an executive committee of the reserve association with the governor, deputy governors, and the Comptroller of the Currency as members. The reserve association as thus organized was to rediscount paper for its members and to hold deposits for them but without interest thereon, hold deposits for the government, fix rates of discount and publish them, issue notes, invest in United States bonds, open banking accounts in foreign countries, and trade in paper abroad. A report was required to be filed with the Comptroller of the Currency once a week and national bank examiners were to be required to file their reports concerning the condition of member banks in duplicate, one copy with the reserve association and one with the Comptroller of the Currency. National banks were forbidden to continue the issue of circulating notes and provision was made whereby the reserve association could purchase their government bonds held as security behind such circulation, converting the bonds so bought into 3 per cent bonds and issuing its own notes as the national bank notes were presented for redemption. The reserve association was to assume the direct responsibility for such notes as fast as it purchased the bonds on which they were based. The reserve association was required to hold a cash reserve behind its outstanding notes amounting to 50 per cent, but was allowed to let this reserve decline on condition of payment of a special tax graduated according to the reduction. A special tax on notes issued in excess of \$900,000,000 was also to be levied. Special concessions were made to national banks for the purpose of rendering their business more profitable. They were allowed to use a greater latitude in the investment of their time deposits and were given a somewhat larger power of lending upon real estate. They were authorized to accept bills and drafts under specified conditions and authority was

granted them to unite for the purpose of jointly establishing foreign trade banks.

Criticism of Measure

The Aldrich bill as just briefly sketched was essentially a measure of the same kind that had been frequently recommended and discussed in time past. As will be seen at a later point its essential provisions were the same as those which had made their appearance in the Fowler and Mühleman bills as well as elsewhere, and contained little that was new. The important features of the measure lay in the fact that it was a bolder and more daring proposal than any that had preceded it, that it grouped together many suggestions which had previously taken form only in a sporadic and isolated way, and that it afforded a more carefully worked out and more consistent whole than was furnished in perhaps any of the earlier measures.

The criticism legitimately to be brought against the bill was found in the fact that it was so exclusively a bankers' measure. It did not seek to interfere with the existing evils of banking which grew out of the reserve city deposit system whereby banks all over the country were authorized to count balances with city banks as part of their reserves, nor did it make any distinct provision for ending the evils of the clearing house system and introducing a régime of uniform and moderate exchange charges. It fell into the serious error of supposing (and this was constantly urged in later utterances by members of the Commission and others) that the rate of discount to be fixed by the association could be wisely made uniform throughout the United States. Failing to provide for any unified deposit reserve, it was driven to adopt the obsolescent German plan of issuing notes to be used as reserves by member banks and permitting these notes to remain idle or dead in the vaults of the several institutions with no necessary provision for insuring their redemption. To some

it seemed a ground for criticism that, in addition to these objections of general and theoretic nature, the measure should have given the control so fully into the hands of the larger banks of the country by providing for a voting control based upon capitalization. Remembering that this voting control was coupled with an apparent concession to the political powers which was largely nominal, and remembering the long life of the charter—fifty years—as well as many other provisions calculated to work in the interest of permanency and independence, there is no resisting the conviction that the new measure would have established a central bank of unprecedented power and authority whose function it would have been to support its members but whose funds were quite clearly to be used primarily for the sake of the larger members (discounting being limited to the amount of a bank's capital) while it seemed probable that an inelastic and more or less unsound note issue might have easily resulted from the provisions of this proposed law.

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Lack of Support

The Aldrich bill was speedily introduced into the Senate but attracted comparatively little support. The feeling of the public at the time was undoubtedly adverse to any such measure and was unduly suspicious toward any kind of banking reform which even squinted in the direction of centralization. Much more was it sure to be hostile to a measure framed as had been the Aldrich bill and intended to give to the banks extensive and valuable privileges.

A critical estimate of the work of the National Monetary Commission really amounts to a critical estimate of the Aldrich bill itself and this can be more effectively rendered at a later point in the present volume, after careful study has been given to the process by which the Federal Reserve Act was gradually developed. Such a study will throw light upon many of the aspects of the Aldrich bill which necessarily escape at-

tention in a first reading or which are passed over by those who deal with the subject from a purely abstract standpoint. The Aldrich bill never received thorough discussion either in committee or on the floor of either house of Congress. Nor was the discussion given to it by publicists very much more satisfactory, since it assumed a partisan tone almost from the beginning. What is said here, therefore, is intended merely by way of preliminary estimate and is offered primarily for the purpose of giving to the Aldrich measure its true status as a predecessor of the Federal Reserve Act.

Relation to Federal Reserve Act

As will be seen in a later chapter, the Aldrich bill by reason of its almost immediate adoption by the leaders of the Republican party, by reason, too, of its indorsement by the Secretary of the Treasury and indirectly by the President of the United States, was unquestionably the leading proposal before the country at the time when the actual formulation of the Federal Reserve Act was begun. In framing the latter measure, accordingly, constant reference was made to the Aldrich bill, both for the purpose of taking from it anything which seemed to be of value and for the purpose of avoiding those features which obviously violated the canons of sound and scientific banking. It must be regarded, therefore, as having been an influence of a high rank in the general monetary and banking discussion which preceded and followed its publication. Coming as it did as the latest in a long series of banking proposals and drawing as it did freely upon its predecessors, the measure must be regarded as embodying much of the discussion of the preceding decade or two. In a certain sense it, like the Fowler bill and the Federal Reserve Act, was based upon the experience of American banks in organizing themselves for mutual protection through the issuance of emergency currency during the periodic crises and suspensions which had occurred from time to time in former

years. To the Monetary Commission, therefore, may freely be given the credit of having developed and put before the country, or at all events of having sponsored, a measure which rendered concrete and definite the aspirations of the larger banks. It did something which the academic discussion of the preceding years had failed to accomplish, since it offered as a distinct proposal a measure which could be used at least as a basis for discussion. This was an important service even though a careful analysis of the material compiled and published by the National Monetary Commission in its study of foreign banking largely fails to sustain the essential provisions of the Aldrich measure. There was, indeed, but little connection between the scientific work done by the Commission and its practical proposals of legislation. Doubtless the work it did had an effect in building up a substructure of interest in and knowledge about the banking question which was of service when the time came for an actual effort to secure legislation from Congress. Beyond this the measure must be regarded as having been little more than a fine gesture—a declaration on the part of important financial interests of the extent to which they were willing to go in what was called “banking reform.” It was regrettable that when the actual work of legislation began no small proportion of the provisions of the Aldrich bill taken over in one form or another into the Federal Reserve Act was antagonized by the financial community which had praised them.

Propaganda Work

One outcome of the work of the National Monetary Commission which may or may not have been expected by those who began or furthered its work was the establishment of various organizations for the promotion of legislation. It was not long after the Commission had finished its work before the banking and business interests of the country which had desired to obtain correction of the principal evils under

which the nation was suffering perceived that, since the proponents of the Aldrich measure had lost their hold on Congress, it would be necessary to organize public opinion in order to convince Congress of the necessity of taking some action. The question whether to make the organizations that might be established work toward the enactment of the Aldrich bill itself or make them work toward the acceptance of general principles, leaving the precise form in which these principles were to be embodied, to be worked out by the members of Congress themselves, was a disputed point from the very beginning. It would seem that there were many who thought it best to make demand for the enactment of the Aldrich bill, leaving Congress then to amend it as might be deemed best, in the course of the actual legislative discussion. Other counsels, however, prevailed and the result was to bring about the organization of public opinion along lines whose purpose it was to advocate general principles. It was not strange that in such organizations there should have been many who believed that eventually the strength that might be developed would be turned toward the actual support of the Aldrich bill as the foremost legislative proposal then before the country. That this opinion was positively expressed more or less openly during the three years from 1910 to 1913 and that it in no small degree colored the work that was actually done by the organizations which interested themselves in the currency and banking question, was also a natural outcome.

Attitude of Economists

The attitude of the economists of the country toward the question of banking reform subsequent to the adoption of the Aldrich-Vreeland Law was one of peculiar and almost anomalous character. Although, as already seen, there had been comparatively little economic discussion of the banking reform movement from any standpoint which involved the organization of a central bank or of any centralizing mecha-

nism, the academic community was inclined to fall into line with the movement toward a central bank and to make but little opposition to it. Several good reasons for this attitude can be mentioned. Perhaps the most obvious was the fact that study of the banking history of the United States and of foreign countries undoubtedly led the mind instinctively toward the acceptance of the central bank idea as the basis for banking reform. It was not only logically attractive but was also supported and buttressed by the facts of history and of local experience. Contemporary observation in Europe tended also to sustain the notion of a central bank. Another reason for the fairly general support accorded to the central banking idea was the tendency of the larger banking institutions of the country to favor the notion. There was always a tendency of academic observers to be influenced in some measure by the testimony of practical men, not only because of their immediate touch with affairs but also because of the general tendency to discredit a purely academic point of view and to regard it as in some way not deserving of confidence when it has to do with financial or business developments. To these obvious and natural factors influencing the academic attitude of the country was to be added the success enjoyed by the National Monetary Commission in associating with itself on the scientific side of its work some of the best authorities in the university world.

Growth of Public Opinion

Perhaps the effective development of public sentiment on the side of some thoroughgoing legislation directed to the amendment of our banking and currency laws was the best and most effective result of the Aldrich or National Monetary Commission activity. Had it not been for the work thus done, the community at large might have gone on in the old hand-to-mouth fashion. Nothing had come of this indifferentism in years past. The shock of the panic of 1907 had resulted

only in the almost worthless Aldrich-Vreeland Law. Had that law made no provision for the study and agitation of the banking question there is every reason to suppose that the community would have continued in the old way until the arrival of another panic or stringency once more compelled attention. As things turned out the next occasion, when conditions became such as to necessitate heroic measures, was found in the difficulties produced here by the European war. What legislation might then hastily have been enacted by Congress and how such legislation might have figured in the later war financing is a vague but alarming field of conjecture.

The work of the National Monetary Commission hastened the crystallization of public opinion, furnished a nucleus around which to develop a body of support for effective legislation, and, while it never provided a plan which was either scientifically sound or politically feasible, it did undoubtedly result in drawing together the suggestions, recommendations, and proposals which had come from many sources during preceding years, embodying them in a more or less consistent whole. This in itself was a service of considerable moment and for this full credit and recognition should be given the National Monetary Commission and to the Aldrich bill which grew out of it. On its scientific side, too, the Commission should have generous recognition for the results it attained in the publication of the series of volumes relating to current banking and to the historical side of banking development. If in this series of volumes there was much chaff mixed with a relatively small quantity of wheat, the series was no different from most others of like sort. It did develop a certain quantity of useful information and at the same time placed in available shape a still larger quantity of other information previously more difficult to obtain in convenient form. For all this it has received, as it should have, due recognition.

CHAPTER V

POLITICAL PARTIES AND BANKING¹

Banking in Politics

After the two sessions of the Sixty-second Congress, the two chief political parties of the country confronting a presidential election which involved a contest of unprecedented bitterness, found themselves at length forced to face with greater seriousness than theretofore the question of banking reform. The fact that changes in American banking legislation were needed had been recognized for many years past.

That such reform could be had, few had been willing to admit. Unexpected improvement in the outlook for ultimate legislation has subsequently led many to think too lightly of the obstacles then in the way. They had neglected the fact that what was to be done had to be done through Congress, and that the temper and composition of that body—its prejudices, precedents, and political necessities—would inevitably color and shape the action taken. How Congress itself viewed the question of banking legislation was an element in the problem of legislation which has been too often neglected. It was too frequently assumed that, granted the force of an aroused public opinion demanding congressional action, the result would be enactments of the type desired.

This overlooked the fact that public opinion can seldom dictate either the form or the details of legislation, and can at best indicate only the general drift of what it desires. The compromises that are resorted to in reconciling conflicting

¹ In the preparation of this chapter, and in some few sections of earlier chapters, use has been made of an article by the author entitled "The Banking Question in Congress," *The Journal of Political Economy* (Nov. 1912), Vol. 20, No. 9.

views, the concessions to various interests that are permitted in shaping the laws, are largely within the determination of the legislative body itself, and are only remotely subject to the dictation of the community. Experience in the past has shown what Congress is likely to do under certain leadership, and has thereby indicated the points at which special precaution is needed to protect the community against dishonesty, errors of judgment, or fatal compromises.

Hostility of Legislators

Probably the most immediate obstacle to real success in banking reform was found in 1910 and the years thereafter, in the hostile predisposition of Congress. For many years, it had been the fashion to object to anything looking to sound legislation on that subject. Why this should have been so is a question which can be answered only by a reference to the conditions which had long permitted complex industrial and financial issues to be made the subject of partisan manipulation and misrepresentation. For years after the Civil War such questions as the tariff, currency, banking, bond issues, and the like, were vehicles for the expression of fanatical and partisan views, often carefully calculated for the purpose of imposing upon ignorant voters who were susceptible to appeals to prejudice.

It would be difficult indeed to say which of the two old parties was the more guilty in this respect. Both sought to make use of popular prejudice for the attainment of their own ends, and the Republicans must probably be blamed only for being more successful than their Democratic rivals in the infliction of their notions upon the country. From the period of the inflation bill, during the second Grant administration, down to the Sherman Silver Purchase Act of 1890, the history of Republican legislation on the subject of money and banking had been a long record of disgrace and misrepresentation. The Democrats, starting creditably with the repeal

of the Sherman Act of 1893, swiftly fell under the control of the more bitter and extreme members of the party and were obliged to yield to Bryanism and to swear allegiance to the silver heresy. The imperfect Gold Standard Act of 1900 was the only redeeming action on the part of the Republicans after the crucial campaign of 1896, and even that was passed with fear and trembling because of the widespread character of the demand for a free silver policy. The Republican party could certainly not complain that the demand for better banking legislation had never been cogently represented to it, for the reverse had been the case. For fifteen years the banks of the country had been demanding relief from the evils of the bond-secured currency system; and, since the panic of 1907, the abler minds among them had been urging the necessity of a better general organization of commercial credit. Yet the abortive and useless Aldrich-Vreeland Law of 1908 had been the sole reply to their requests, and even that was granted only under the greatest stress and urgency. There was little ground either to believe that the party leaders were well informed about banking, or to expect that they would be disposed to put their views into effect if they were. In session after session the most urgent representations had been made to the Republican leaders. Bill after bill designed to relieve the existing conditions had made its appearance at the Capitol, only to be relentlessly rejected by the political triflers and jugglers who were in charge of events. Of the long series of measures proposed between 1900 and 1908, not one received the barest consideration, and not one was granted the courtesy of a debate on the floor. They could be brought before the House only by some *tour de force* which resulted in permission to speak, accompanied with "leave to print."

Lack of Thorough Discussion

A most serious hindrance to the passage through Congress of any real legislation with reference to banking or cur-

rency questions lay in the lack of satisfactory organization for the discussion of the subject. Under the existing system in the two houses, bills on these subjects were referred to the Banking and Currency Committee of the House of Representatives and the Finance Committee of the Senate. Whatever was to be done must theoretically pass through those bodies, unfavorable as they were to any serious measures of reform.

The Democratic party, in reorganizing the House of Representatives after 1910, followed in the main the system of seniority which had been enforced during the Cannon régime. Such a system promoted to the headship of the committees those who happened to rank highest in seniority, independent of their knowledge of banking or interest in the subject. It would in any event have been likely to bar any who might have been specially capable to direct such work from the position of headship requisite to success.

But as a matter of fact, it was not necessary to face a situation where a wealth of expert ability was offered without power to make use of it. The Democratic House which came into office in the spring of 1911 contained an unusual number of absolutely new and inexperienced legislators. In many parts of the country the "landslide" which resulted in ousting the Republican House had not been expected. The men who were put forward by the Democrats were frequently younger men who were willing to lead a forlorn hope. So far as knowledge of banking was concerned, therefore, those who undertook to choose the Banking and Currency Committee along with the other committees, at the beginning of the special session of the Sixty-second Congress, would have found little in the way of expert capacity within their reach.

Moreover, the committee-makers failed in many cases to choose for the new Committee even the most capable men they might easily have selected. There was a prevalent feeling at the beginning of the Sixty-second Congress that the Com-

mittee was likely to remain dormant throughout the coming two years, and that nothing was less probable than immediate initiation of measures on its part. Under these conditions, the managers, perhaps, were not especially open to blame for placing upon the Committee a body of men only two of whom had ever seen service in Congress and none of whom, with the exception of these two, had ever before participated in the shaping of legislation upon such a subject. With the system of committee appointments which prevails in Congress, the new appointees could not have successfully protested against being thus placed even had they chosen to do so.

Technical Nature of Problem

The question of banking and currency legislation, however, is essentially technical. Men cannot originate measures relating to it without previous study or experience on the subject. It would have been impossible and absurd to expect from a wholly untrained committee instant action fitted to remedy one of the most entangled and difficult economic conditions by which the country had for years been confronted. But this raised the immediate question: Why should not this committee, so composed, simply accept the legislation proposed by the National Monetary Commission, give it an indorsement, report it, place it before the House of Representatives, and demand its enactment? No one familiar with legislative conditions, whether in Congress or elsewhere, would for an instant suggest that such action could be taken except under one of three conditions. It would be necessary either: (1) that there be a mandate from the party leaders specifically calling for action by the Committee favorable to the measure proposed by the National Monetary Commission; or (2) that there be absolute and perfect confidence on the part of the Committee itself in the work of the National Monetary Commission both as a scientific and as a political matter; or (3) that there be so unmistakable and extensive a popular demand

the country over in favor of this legislation or something closely akin to it as to make clear to the Committee the political wisdom of taking the action desired.

As a matter of fact, the leaders of the party had clearly understood among themselves that there was no harmony in their own ranks as to what should be done. They had not been convinced of the existence of a widespread popular demand for any action. They had consequently been disposed to suspend judgment, refrain from issuing orders, and leave the Committee to act as it chose. With reference to the National Monetary Commission itself and the degree of confidence reposed in its findings, there had been no doubt in the minds of Congressmen. Whether Republicans or Democrats, they had with one accord refused to believe in the work of the Commission. There were several reasons for this attitude, partly psychological, partly political, and partly personal. The general distrust of former Senator Aldrich, the chairman of the Commission, which, whether merited or unmerited, was prevalent in Congress as well as out of it, accounted for a reluctance to act on the findings of the Commission which had been characteristic of the new Congress.

Rightly or wrongly, members of both parties had refused to take the report of the Commission on trust, inasmuch as Mr. Aldrich was its head, independent of the question whether or not he had actually had much to do with the framing of its plan or not. Politically, it had been found that the so-called "Bryan element" in the Democratic party was still strong, and would resist anything calculated to render banking easier or more profitable. Politically again, the acceptance of the work of a commission organized under Republican auspices and dominated by members of the Republican party could hardly be thought of. Here again the question was one of political advantage. There had been nothing to indicate that the acceptance of the plan of the National Monetary Commission would be wise from the selfish standpoint.

Convinced that such was the case, and lacking conviction that the plan of the Commission would wisely and satisfactorily dispose of existing difficulties, it was easy to see why members had taken no steps. There remained, therefore, only the question whether the public at large could or could not be induced to express a definite opinion in favor of banking and currency legislation of a distinct kind, and could or could not make this opinion effective with the leaders of Congress, with the Banking and Currency Committee, and, to some extent, with the rank and file.

Membership of House Committee

At the session of 1910-1911 the Banking and Currency Committee of the House of Representatives was composed not only of new members but contained a large element of members who did not expect to return to Congress. The chairman of the Committee had already announced his intention not to come back. Several other members, for one reason or another, were already certain not to reappear. The Committee, therefore, was a body whose interest in securing legislation was decidedly less active than it would have been under some other conditions. Nor was the situation very much more hopeful in the Senate, although it was decidedly different. The membership of the Finance Committee included on the Republican side Boies Penrose of Pennsylvania, S. M. Cullom of Illinois, H. C. Lodge of Massachusetts, P. J. McCumber of North Dakota, Reed Smoot of Utah, J. H. Gallinger of New Hampshire, C. D. Clark of Wyoming, W. B. Heyburn of Idaho, and R. M. LaFollette of Wisconsin. On the Democratic side it included J. W. Bailey of Texas, the ranking minority leader, F. M. Simmons of North Carolina, W. J. Stone of Missouri, J. S. Williams of Mississippi, J. W. Kern of Indiana, and C. F. Johnson of Maine. While none of these men, except Kern and Johnson, were figures of recent arrival in the Senate, very many of them were new

figures in the Finance Committee. There were a few who had survived the reorganization which followed the substitution of syndicate control of the Republican machine for the autocratic power of Nelson W. Aldrich. But even of these men, hardly any professed familiarity with banking questions or would be serviceable in drafting a bill. Senator Bailey of Texas, one of the older members, openly professed a belief in government issues of notes, and probably nothing much better could be expected of the Democrats associated with him. The bulk of the Republicans were either admittedly ignorant of the whole subject or inclined toward erroneous financial theories. A few were not committed to anything and were seeking to inform themselves, but even they were not particularly well prepared to do so. While, however, the reasonable expectation would have been that the Republican majority on the Committee would simply indorse the main features of the National Monetary Commission plan, there were some reasons why this could hardly be done. Experience during the preceding two years had shown that the Senate was sharply under popular suspicion and that its membership was by no means so firmly seated in the saddle as had formerly been the case. On the floor, at least three groups—conservative Republican, progressive Republican, and Democratic—had been formed, none of them possessing a majority; while a further tendency at times to break up still more into four groups, three of which were needed in order to secure a majority on any contested question, had been observed. This meant, therefore, that the leaders of the Finance Committee, even if they could succeed in favorably reporting a banking measure of the type referred to, would not do so unless they were guaranteed effective support for it on the floor. They had no such guaranty, but, on the contrary, could safely assure themselves that almost anything they might do would be subject to intense criticism and would fail of success unless it could gain the support of at least two of the different groups among the members.

The Finance Committee, therefore, was very nearly as likely to look for outside guidance as were the House leaders. Where could this guidance come from? Could it be supplied at all? Were the methods that were being pursued in some quarters to that end likely to succeed? It was doubtless the recognition of the fact that a definite public opinion must be formed and expressed that had led to the creation of popular organizations designed to further the banking reform cause.

Country Bank Position

There had been no trouble, relatively speaking, in concentrating upon Congress much influence proceeding from the banking and business part of the community in favor of a plan of the general character of that proposed by the National Monetary Commission. Yet this had left Congress cold and untroubled. The reason was to be found in the fact that congressional support is largely drawn from the country districts. The number of members of the House who represented city constituencies was relatively small. In states where the primary system had become established, senators were far less subject to city influence than in the past. It was, therefore, necessary in every great measure of legislation to secure action which would certainly not offend country constituencies or which at all events would give them no ground for offense. The fact was that the country districts at the time knew and cared little or nothing about the question of banking. It was nearly impossible to galvanize them into interest on the subject, and out of the question to educate them intelligently regarding it without long and persistent effort. The plan of the National Monetary Commission, even had it embodied the sum of wisdom on banking, could not have been forced in any short time upon the rural voters of the country. But while it was thus difficult to secure action compelling the adoption of that plan or of any like it, there was equal difficulty in stirring up an intelligent opposition to it or to any other. Why then,

it was constantly asked, should not members of Congress accept some modified form of the plan of the National Monetary Commission, backed as it was by a considerable amount of commercial and banking support? The reason was that in the state of affairs then existing such action would have immediately been seized upon by political opponents as a basis for criticism. This would not so much have mattered had it not been that each party was divided within itself. Any member of either party who had voted for a given plan would have found his action attacked by his political rivals both within and without the organization. He could not have endured the strain. His rivals would have appealed to the latent feeling on the "trust" question, and to the openly avowed hostility to the Money Trust which prevailed so generally throughout the country. He could not and would not have endured the pressure to which he would have thus been subjected, nor willingly suffered from the inevitably distorted interpretation of his action with reference to a peculiarly complex question. He would rather have avoided taking any step whatever.

Party Measure Impossible

It was thus plainly true that under existing conditions no measure of comprehensive scope could be passed by purely party action. It had to be obtained by decisive action and by leadership originating with men determined to act upon the legislation in question for the sake of the public benefit to be derived therefrom, and laying aside all preconceived prejudice in favor of or against any given program or plan. Nothing stood more in the way of the attainment of results than the persistent and determined hostility of those who had given their adherence to some given scheme of currency or banking reform. It was comparatively easy to indicate many roads by which the reform legislation could be obtained. Probably in this case, as in all others, nothing could have been adopted that would be held as a final and rounded plan.

But, as throughout the whole experience of the past in banking legislation, the great obstacles to success were in 1910 and the two years following found: (1) in the action of those who were persistently set upon the acceptance of a preconceived scheme of legislation, and (2) in the attitude of the machine leaders who, without knowing much about the subject, waited to hear from the country, heard nothing definite, and so remained inactive or sought to adopt a measure conceived in their own ignorance. There was need of strong and moderate leadership, but even that had to be unsuccessful unless it could unite behind it the sober elements in both old parties in support of some plan different from any thus far proposed, free of the elements which had conspicuously called forth opposition, and providing straightforward simple remedies for existing evils—remedies capable of sincere and comprehensible defense.

Mr. Glass as Leader

Above all things it was necessary to find in Congress a member who was single-minded and sincere, alive to the necessities of the public in a technical and complex matter, and able to choose wisely and sanely between the various alternatives presented to him. It was essential, moreover, that such a leader should be free even of the suspicion of allegiance to the moneyed interests and equally free of hostility toward them. Given such a congressional leader it would be possible to make head against the insane forces of uninstructed radicalism and at the same time to thrust aside the demand of the selfish interests which clustered around the larger banks of the country.

There was one member of Congress—certainly only one member of the Banking and Currency Committee—who in any measure satisfied these essential requirements. Carter Glass had occupied a seat in the House of Representatives for about ten years, entering Congress first in 1900. He came from a Virginia district largely rural and in which banking and financial interests had no hold. Later when a league of

citizens interested in banking became dissatisfied with Mr. Glass's policies and gave orders to "build a fire behind" him it found the fuel for such a conflagration singularly absent. The hardheaded farmers and small business men of Virginia paid no heed to Wall Street or even Richmond murmurings and Mr. Glass was able to pursue the course he had mapped out for himself without heeding or compromising with those who had believed themselves able to threaten his seat unless he would consent to take orders.

As a member of the House Banking and Currency Committee Mr. Glass had for many years followed with interest the gradual development of banking thought in the United States and in Congress. He had labored during the years of Republican control in such ways as were permitted to a Democratic minority member, to advance the interests of sound thought and legislation. The old seniority system of selection had necessarily placed at the head of the Committee the ranking member of the former Democratic minority, Representative Arsène P. Pujo of Louisiana. In this, of course, Mr. Glass had, as a loyal organization man, fully acquiesced, though Mr. Pujo had no strong interest in and firm grasp upon banking principles and measures. Yet the question was of course recognized as urgent from the very opening of the period of Democratic control of the lower house what would be the direction of Committee action and how far the Committee would be able to cope with what was generally recognized as the most dangerous and difficult of the issues which the party must settle.

Opposition of Conservatives

As for the so-called leaders in the House, they undoubtedly distrusted or doubted Mr. Glass. Whether it was they who later influenced some members of the coterie of politicians that sprang into mushroom-like prominence with the election of Woodrow Wilson in 1912, or whether the latter reacted un-

favorably upon the congressional clique—certain it is that Mr. Glass was not viewed by the controlling factors in the House as likely to assume a foremost place in the councils of the party relating to finance. The leaders regarded the Banking and Currency Committee as of only moderate capacity, if not in fact even lower than this in the scale of ability. They wished to keep it, on the whole, in a relatively inactive condition that it might do as little harm as possible. In the Senate the remnants of the Old Guard of the Republican party were making a last stand before the onslaughts of the so-called Progressives, who were being goaded into activity by the Roosevelt element in the Republican party. The Finance Committee maintained its powerful hold on a vast field of legislation, including the whole subject of banking currency. It was an inauspicious moment for the development of a measure which had to make its way against the thoroughly organized elements and interests who were urging the Monetary Commission bill upon Congress and upon the nation.

Democratic Platform

Meantime there had broken out within the Democratic party a severe struggle among a group of leaders representing various elements in the organization. These leaders were conducting independent campaigns for the nomination which was to be awarded by the convention at Baltimore. Some of them thought best to prepare tentative platforms of their own in which they stated their views upon a variety of subjects either for use in the primaries or for general circulation. One of these was Senator O. W. Underwood, at that time probably the leading Democratic member of the House of Representatives. Mr. Underwood, while not committing himself definitely to any particular bill, nevertheless made a general declaration which was satisfactory to the so-called "Conservatives," including some at least of those who were supporting the Aldrich bill. Much more vague and uncertain statements

were put forth by others. Mr. Wilson, then governor of New Jersey, made, so far as known, no declaration whatever as to his position, leaving the matter for later discussion. The Baltimore platform as eventually accepted and of course indorsed by the candidate contained the following clause:

We oppose the so-called Aldrich bill or the establishment of a central bank, and we believe the people of the country will be largely freed from panics and consequent unemployment and business depression by such a systematic revision of our banking laws as will render temporary relief in localities where such relief is needed, with protection from control or dominion by what is known as the Money Trust.

Republican Platform

It very early became a problem with the politicians how they should deal with the banking and currency question in the campaign of 1912. There had been for years past the bitterest of political controversies centering about the question of banking and currency. The Democrats had won control of Congress at the last preceding election, but only because of the misfortunes of President Taft, the mistakes of the Aldrich tariff, and a number of fortuitous elements. They had moreover learned some wisdom, and in these congressional contests they had carefully refrained from mentioning banking and currency. On the floor the subject had not been allowed to get a foothold, save for the Money Trust resolution which was deplored by many and whose application had been deferred by the politicians until after the election. How to handle the situation tactfully and effectively in the campaign was thus a very serious problem. Addressing themselves to this question, the Republicans in convention at Chicago eventually decided to give a half-hearted support to the Aldrich currency measure and accordingly adopted the following "plank":

The Republican party has always stood for a sound currency and safe banking methods. It is committed to the progressive development of our banking and currency system.

Our banking arrangements today need further revision to meet the requirements of current conditions. We need measures which will prevent the recurrence of money panics and financial disturbances and which will promote the prosperity of business.

Meaningless Controversy

Neither of these planks had any very definite meaning and neither was apparently regarded by politicians as amounting to very much. Both were considered as being unavoidable or necessary concessions to popular prejudice or to popular demand for some announcement on the subject. The effort was made so far as practicable to keep the question at least somewhat in the background during the campaign, although sporadic attacks on the Aldrich bill from time to time occurred. Throughout, however, there was the uneasy consciousness that the subject was a real matter of concern in the public mind, that it would not be possible to defer consideration of it indefinitely, and that as a matter of fact some action one way or the other would probably have to be undertaken at a very early date in the new administration. This necessity was undoubtedly viewed by politicians as one of the most disagreeable elements in a difficult situation, while by the business public it was regarded as one of the least satisfactory phases of the current campaign. Doubts and fears as to what would be done, predictions of an unfavorable outcome of the discussion, and pessimistic forecasts of the situation to be produced by new legislation were common. It was this uncertainty, this lack of definite prospect, which inclined practically all public men to defer any serious consideration until it could be seen who would win at the polls and what would be his attitude. In these circumstances a great advantage had been gained by the Banking and Currency sub-committee in its determination to have at least a tentative draft of the proposed measure prepared for possible use immediately after the election, should the result permit immediate steps forward.

CHAPTER VI

THE MONEY TRUST INQUIRY

Timidity of Democratic Leaders

The effort and desire of leaders in Congress to steer clear of any action that might have an unfavorable bearing upon the prospects of the Democratic party in the presidential election of 1912, grew stronger as the chances of their success in that contest increased. As dissension within the Republican party rose steadily toward a climax, it seemed more and more probable that a Democratic President might, for the first time in two decades, be elected. Yet, in spite of this disposition to keep matters quiet and to avoid any intraparty discussion between "sound money" Democrats and Bryan dissidents, the issue was too urgent to permit a Fabian policy of this sort to succeed.

Comparatively early in the long session of 1910-1911, there arose a strong demand for the adoption of a congressional resolution which would authorize an inquiry into what was then currently known as the "Money Trust." There had been grave abuses of banking and credit power, which for a decade past had grown more and more marked while the evident decline of government influence over the direction of banking development had strongly borne it in upon many minds that corrective measures were needed. Various committees of Congress had already succeeded in acquiring for themselves and their members a good deal of artificial notoriety by investigations of government departments which they had set on foot. It was natural that some members of Congress, both in and out of the Banking and Currency Com-

mittee, should believe that they saw an opportunity for gaining some popularity with the rank and file of citizens. Hence a strong and general demand for action by that Committee prior to the arrival of election.

Origin of Money Trust Inquiry

Exactly how or with whom the Money Trust inquiry originated cannot perhaps be definitely stated. It was provided for by a resolution which authorized the Committee on Banking and Currency of the House of Representatives to undertake the work. This resolution¹ was adopted on February 24, 1912, and specified the purpose of the investigation as being "to obtain full and complete information of the banking and currency conditions of the United States for the purpose of determining what legislation is needed." The amendatory legislation passed the House on April 22, 1912, and was much more elaborate, calling for investigations into sundry "charges" directed against the "management of the finances of many of the great industrial and railroad corporations of the country." The resolution as thus finally framed went on to specify a great number of detailed points into which inquiry might be made, among them being the familiar questions of interlocking directorates, the use of funds by insurance companies, the operations of the New York Stock Exchange, and Clearing House, the payment of contributions to national campaign committees, and a variety of other matters of the same sort.

In the beginning, the adoption of the resolution was probably the outgrowth of the desire to take some steps which would put the party into position to develop a policy regarding money and banking legislation, many of the leaders feeling that there was no general consensus of opinion on that subject and that the sooner effort was made to bring it to a head the better for all concerned. The question whether the party should allow itself to drift off into a general attack upon the

¹ H. R. Res. 429, afterward extended by H. R. Res. 504.

existing organization of the banking of the country was one which naturally raised great doubt in the minds of many party leaders, and especially those of the "conservative" variety. It was therefore determined to bring the matter to the attention of sundry of the men most prominent in the party at the time and most likely to be favorably considered for the presidential nomination. Among these were Speaker Clark of the House of Representatives, Woodrow Wilson, then Governor of New Jersey, and as usual, W. J. Bryan. It was a foregone conclusion that Messrs. Clark and Bryan would favor such an investigation but there was grave doubt as to the position of Mr. Wilson. He, however, announced himself as being in favor of a Money Trust inquiry, as the investigation for some reason had come to be known, and his view on the matter was indicated authoritatively at the time of the Jefferson Day dinner held in Washington in 1912. With the candidates all committed to the undertaking, congressional leaders felt safer in pushing forward with their inquiries in the belief that whoever might win the nomination would now be committed to the notion of carrying forward some attack upon the financial interests.

Old-Line Leaders Hostile

The inquiry thus provided for, however, did not altogether commend itself to the old-line leaders and they succeeded in securing the postponement of it in any active form until after election. Only a few hearings were held before that time, and although there were reports during the summer regarding the work which it was intended to do, nothing was actually accomplished prior to the campaign. As the final report of the Committee expressed it, "the refusal of aid by the Controller" and other administrative and legislative difficulties as well as "the suspension of public hearings during the presidential campaign," naturally prevented progress in carrying it out.

The action as originally taken was significant in many

ways, but in none more than as illustrating the depth of the division of opinion between the two elements in the Democratic party. Mischief makers both within and without Congress, men with grudges to satisfy and axes to grind, hailed the adoption of the resolution as the signal for the satisfying of their claims and demands. Samuel Untermyer, a figure prominent in certain circles in New York and by reputation a Democrat, had been instrumental in forcing upon the House the Money Trust resolution, and the Banking and Currency Committee, to which the investigation of the Trust had been committed, under the terms of the legislative action as adopted was now asked to select him as its counsel and to commit to him the direction of its inquiries. But just at this point the so-called "Bryan wing" of the Committee sustained a severe defeat.

Division into Sub-Committees

Shortly after the action of the House had been taken, the question of organizing and planning the Committee's work was brought up in the Banking and Currency Committee and attention was called to the fact that the duty before the Committee under the resolution really included two distinct branches of work. One of these, it was urged, related to investigation of abuses, pure and simple, while the other had to do with the formulation of bills designed to afford a constructive remedy for the banking and currency evils of the nation and to provide such reform measures as study might show to be desirable. Robert J. Bulkley of Cleveland, Ohio, accordingly proposed that the Committee divide into two sections, of which one should be investigative—dealing with the Money Trust—while one should be scientific and constructive—dealing with proposals for legislation. The plan was accepted by Chairman Pujo, and though in some measure distasteful to the radical wing, was agreed to by the members of that group in Congress. Unquestionably the action so taken was of crucial significance.

since it in effect turned the flank of the "soft money" or Bryan wing of the party and insured careful consideration of new legislation by the soberer elements of the Committee. This phase of the situation became clear when Carter Glass was named chairman of the sub-committee on legislation, Mr. Pujo retaining the headship of the investigating sub-committee.²

The subsequent history of the Money Trust inquiry is of direct importance to the development of banking and currency legislation chiefly for the light it throws upon the motives and methods of those who were then dominant in the Democratic party and upon the attitude of certain elements in the financial community. From these points of view, it is worthy of some general analysis.

The investigation itself took form as a lengthy series of cross-examinations dealing with the working of clearing house associations, the operation of the New York Stock Exchange, and the concentration of the control of money and credit. After reviewing these subjects more or less exhaustively, and cross-examining a great many witnesses, the Committee finally reached the conclusion that the management of the New York Clearing House Association was unjust to the smaller banks, possessed enormous power, was unincorporated and unregulated, had usurped functions foreign to its usual object, had issued circulation without legal authority, had sought to regulate charges for the collection of checks, and had carried on a variety of undertakings not appropriate to its functions. As

² Mr. Untermyer became counsel to the Money Trust or investigating sub-committee. The source of information regarding the work of that body is to be found in the so-called Money Trust hearing (House of Representatives Banking and Currency sub-committee hearings, 1911-1912, 3 vols.). The author became expert to the legislative sub-committee and continued in that capacity during the year 1912-1913, closing his service with the end of the short session of those years. He continued unofficially associated with Chairman Glass during the period from March 4, 1913, to the appointment of the new Banking and Currency Committee in the special session called by President Wilson for April, 1913. Soon after the designation of the new Committee he was elected expert to the Committee and continued in that capacity up to the adoption of the Federal Reserve Act at the close of 1913. Prior to election as expert to the sub-committee the author had been retained in the service of the National Citizens' League in the preparation of a volume entitled "Banking Reform," and for a short time subsequently preparing analyses and reports upon various proposed measures of legislation. Having concluded this work he passed, at the invitation of Chairman Glass, into the service of the sub-committee.

for the New York Exchange the Committee gave an account of the familiar details of its organization and of the relation of members to it, of the conditions under which stocks are listed, of relations between the Stock Exchange and the Consolidated, of the rules of the exchange with reference to commissions, of the development of "unwholesome speculation," of the growth of "manipulation," of various circumstances under which short selling had occurred with bad results, and of a variety of other details relating to speculative methods.

Centralization in Banking

In dealing with the concentration of money and credit the Committee found an ever-increasing centralization of control in banking, naming various private and other banking houses in New York and attempting to illustrate their affiliations with the railroads and other concerns. In all this it succeeded in setting forth a great deal of familiar material and from that argued strongly the existence of an undue degree of Money Trust power in the hands of a few banks and bankers. The conclusions arrived at included a recommendation for the incorporation and regulation of clearing houses and for the admission of the smaller banks to membership, as well as for a better system of bank examination, presumably to take the place of clearing house examination. It recommended that clearing house associations be permitted to continue the issuance of clearing house certificates until such time as somewhat better provision could be made. In addition the suggestion was made that a general bill to amend the National Banking Law be adopted regulating rates of discount and interest on deposits. This bill, however, as related to the points already enumerated, was rather crudely drafted, apparently for the purpose of correcting tendencies toward "combination." Somewhat similar recommendations were made with respect to stock exchange transactions but they need receive no attention here. On the subject of control of money and credit, the

Committee said that "the bulk of the oral and documentary evidence . . . was directed toward ascertaining whether there is a money trust." On this point the Committee reached the conclusion that if by such a trust is meant a combination pursuant to a definite agreement, it was impossible to state that any such trust had been established. Nevertheless under the existing system of issuing and distributing securities there was a very close and well-defined identity of interest between "a few leaders of finance held together by stockholdings, interlocking directorates and other forms of domination over banks, trust companies and etc., . . . which has resulted in a vast and growing concentration of control of money and credit. . . ." The Committee continued to analyze at some length the methods by which this control was secured and alleged that one of them was through the use of national bank funds in the purchase of securities. Accordingly, it recommended legislation designed to prevent bank consolidations, interlocking directorates, security holding companies, borrowings by officers and directors, and to promote general publicity.

Final Report Submitted

All these recommendations and many others were contained in the final report of the Money Trust Committee which was sent to the House under date of February 28, 1913. The report was accompanied by the drafts of a bill to amend the National Banking Act already referred to, a bill to prevent the fraudulent use of the mails and telegraph in furtherance of harmful transactions on stock exchanges and suggestions for one or two other measures, it being stated that "there was not time to frame bills to carry into effect the remaining recommendations." As will be seen at a later point, this outcome was in a measure the result of a conflict of authority which had developed between the two branches into which the House Banking and Currency Committee had been divided, in consequence of which the task of framing legislation had been

entrusted to a sub-committee charged with the duty of reviewing the entire field of banking and currency and of proposing remedial measures in connection therewith. Chairman Pujo had entered into a binding gentlemen's agreement by which he undertook to keep out of this field. The bill to amend the National Banking Laws recommended by the Committee was on the surface somewhat outside the sphere which had thus been retained by the Pujo sub-committee, but a study of the bill showed that on the whole it related to matters which were not ordinarily regarded as falling within even the rather broad limits customarily assigned to the field of "banking reform." One matter which was covered in the bill and which was afterwards found necessary to deal with in the Federal Reserve Act was the subject of exchange charges on checks. The Money Trust Committee should be credited with having made recommendation for a provision designed to prevent national banks from entering into "any agreement, arrangement or understanding . . . having the purpose or effect of regulating its charges for collecting checks, drafts, notes or bills of exchange for its customers, or of fixing or regulating rates of interest or discount." The Committee recommended no means of making any such provision effective and its suggestion was therefore nothing more than the recognition of a bad condition which had come to exist in our banking system.

Lack of Relation to Positive Reform

As will later appear, the recommendations of the Money Trust Committee in general had no bearing upon banking or monetary reform and were accordingly given no attention by the sub-committee which was simultaneously working upon banking legislation and which later prepared a draft of what was to become the Federal Reserve Act. The question has often been asked, therefore, precisely what the effect of the Money Trust investigation was. A rational answer can be given only after a broad general survey of the condition of public opinion

with regard to many matters of governmental policy. Such a survey would be out of place within the limits of this volume. Only a general judgment therefore can be rendered. As has been seen, the time was one of very considerable political unrest and of deep-seated suspicion with respect to the conditions under which banking and security issues were being carried on. Ever since the insurance scandals of ten years before, this suspicion had been spreading, being checked only sporadically from time to time by the application of remedial measures. The public at large, failing to recognize what had been pointed out by the Aldrich Monetary Commission—that many of these evils were not the outgrowth of wilful perversion of law but were almost inevitable excrescences upon the financial system of the United States due to the existence of defective banking and currency legislation, did not hesitate to ascribe the unfortunate conditions of the times to the undue growth of individual power or to a perverted desire to rob the public. This point of view the Money Trust investigation did much to stimulate, since it encouraged the belief that the existing evils were solely the product of designing men who, aided by irregular alliances with banks, were able to accomplish their objects at the expense of the nation. It undoubtedly tended to create in the minds of members of Congress already prepared for it by many years of unsound currency philosophy a tendency to demand “strong” legislation directed against the “money power.” This unquestionably rendered the task of adopting the Federal Reserve Act very much harder than it otherwise would have been and probably introduced into the measure compromises on points of principle which else might not have been made. From every standpoint therefore the inquiry must be regarded as having been fundamentally injurious.

Legislative Study an Incident

As an offset to this criticism should be remembered the fact that had not Congress at that time made provision for

the inquiry, the work of the sub-committee which eventually was charged with the preparation of banking legislation might not have been undertaken. From this it would have followed that when the new Democratic administration came into office no measure would have been available for its use, and with the influences then powerful in the government there would have been every reason to suppose that the consequences would have been highly dangerous. The formulation of an unsound currency and banking bill could hardly have been avoided and its enactment by Congress would at least have been probable. As matters later developed the adoption of the Federal Reserve Act was rendered possible only by reason of the fact that it had been practically completely shaped, in finished form, before President Wilson took office, and consequently before the many subtle influences which are always set at work upon a new Chief Executive had had opportunity to accomplish their results. From this point of view therefore it may be said with some show of reason that the original Money Trust resolution was the beginning of serious work on banking and currency by the Democratic party, eventually resulting in the formulation of the Federal Reserve Act. With the qualifications and explanations already made, this statement may be regarded as founded upon truth and to that extent should be accepted as an offset to the undoubted harm that was wrought through the Money Trust report itself.

Origin of Clayton Measure

Later effects of the Money Trust inquiry may be traced in the so-called Clayton Act of which more must be said in a subsequent chapter, in proposed amendments to the Federal Reserve Act, some of which in part found their way to the statute book, and in other legislative changes too numerous to mention. It may, perhaps, be fairly said that the Money Trust investigation, being the outgrowth of an unquestionable popular demand, must be regarded as an episode of unquestionable

significance and importance in the history of American currency and banking. It may undoubtedly be classed with the work of the National Monetary Commission although animated by a different purpose, carried on in a different way, and reaching different results; and it may be said that whereas the work of the National Monetary Commission was constructive in that, as already seen, it drew together many recommendations and suggestions previously undigested and wove them together into a more or less consistent piece of work, the measures recommended by the Money Trust Committee were destructive, aiming as they did at breaking down the existing basis of finance, at least in many important particulars, and offering nothing to take its place. Of both it should be said that their effect, whatever it was, was an effect upon public opinion and that neither of them in any large general way did more than to assist in bringing that opinion to a state of concreteness and definition. The work of the Monetary Commission assisted in concentrating the demand of the sober elements of the community upon the need for banking and currency legislation, while in the work of the Money Trust Committee radical elements were able to express their opposition to the ultra-conservatism of the Aldrich proposal and to make clear the dangers which might follow from an enactment that would tend to intensify and aggravate already existing evils. From this point of view the two investigations or reports may be regarded as in some measure neutralizing one another, thereby in a sense clearing the field or tending to render more nearly equal the conflicting elements which had to be brought together and harmonized in order to insure the enactment of a piece of broad general legislation on banking and currency.

CHAPTER VII

PRELIMINARIES TO THE FEDERAL RESERVE ACT

Early Work of Committee

The first step taken by Chairman Glass in preparing for the work to be done by his sub-committee was to ask for a survey of available material and available measures actually or potentially before that body. The design was to provide analyses that would afford a careful comparison of pending proposals. Discussion with the members most interested in the task before the sub-committee, as well as with the sub-committee's expert, resulted in a decision first of all to direct attention to the Mühleman plan, the final Fowler measure, and the Aldrich bill, all of which have been incidentally referred to in the foregoing discussion. An analysis covering the contents of these legislative projects as well as some incidental references to others was accordingly prepared for and taken under advisement by Mr. Glass and his associates. This was the first basis of discussion relating to the new banking and currency bill in the sub-committee. The analysis thus provided read as follows:¹

MEMORANDUM ON VARIOUS SUGGESTED PLANS

The plans for banking and currency legislation suggested by Hon. Charles N. Fowler, in his "A financial and banking system for the United States" (H. R., 23,707); by Hon. Maurice L. Muhleman, in

¹ This memorandum was prepared by the author in his capacity as expert to the Committee. It is here reproduced, not simply as affording information regarding the early work of the sub-committee which was now beginning the drafting of the Federal Reserve Act, but also because in the course of the descriptive and historical discussion with which earlier chapters have been occupied there has been no opportunity for close examination of the relative provisions and merits of the various bills which have been referred to.

his "Plan for a Central Bank," reprinted from the Banking and Law Journal; and by the National Monetary Commission, as embodied in a bill, "to incorporate a national reserve association of the United States and for other purposes" (S. 4431), introduced by Senator Burton January 11, 1912, have the same general purposes in view. They differ in several important details, none of which, however, are absolutely fundamental to the scheme presented.

OBJECT OF PLANS

The object of the plans presented in these three proposed measures is that of arranging a cooperative organization of the banks of the United States which should serve to afford these banks the means of rediscounting their paper at times when they require assistance or accommodation in order to continue extending loans to their customers, and in order to avoid the curtailment of credit which in the past has frequently resulted in precipitating commercial panics and stringency. The fundamental idea running through these proposals is that of centralizing the control of discounts and reserves as well as that of applying a more rigorous method of oversight to the operations of the several banks which are expected to participate in the new scheme. It is supposed by the authors of these plans that the institution which they aim to create would accomplish at least the following financial results:

(1) Establishment of a uniform rate of discount throughout the United States, and thereby the furnishing of a certain kind of control over bank operations which should be similar in all parts of the country.

(2) General economy and centralization of reserves in order that such reserves might be held ready for use in protecting the banks of any section of the country and for enabling them to go on meeting their obligations instead of suspending payments, as has so often been necessary in the past.

(3) Furnishing of an elastic currency by the abolition of the existing bond secured note issue in whole or in part, and the substitution of a freely issued and adequately protected system of bank notes which should be available to all institutions which had the proper class of paper for presentation.

(4) Management and commercial use of the funds of the government which are now isolated in the treasury and subtreasuries in large amounts.

(5) General supervision of the banking business and furnishing of stringent and careful oversight.

Other objects are sought, incidentally, in these plans, but they are not as fundamental as the chief purposes enumerated

COMMON FEATURES

The plans present a general community of design and similarity of arrangement which is not necessarily the outgrowth of plagiarism or imitation, but has resulted from the fact that some proposition of this kind has been under consideration for many years past and has commended itself to leading bankers and business experts, and that the idea has also the support of European experience, nearly every European country being equipped today with a central banking mechanism of some kind. This notion of a central banking mechanism which should economize resources and sustain the several banking units is of obvious desirability provided that various difficulties connected with it can be overcome. It is in overcoming these difficulties and avoiding the embarrassments that necessarily arise from such a proposition, that the three plans under consideration, as well as numerous others of the same general description, vary from one another. These variations are of great significance when it is sought to adopt a piece of practical legislation for the purpose of remedying existing conditions; but they are not fundamentally important from the general theoretical standpoint

POINTS OF VARIATION

The particulars in which the various plans differ from one another are numerous and will be better dealt with in a separate portion of the discussion. All that is attempted in this memorandum is to set them forth in the aggregate so that their relations to one another may be understood. The principal points upon which those who have framed these plans have concentrated attention may be enumerated as follows:

1. Methods of providing capital for the suggested central organization.
2. Relationship between the central organization and branches of the same.
3. Relationship between the institution and its branches on the one hand, and existing banks on the other.
4. Relations between the proposed institution and its branches on the one hand and the public on the other.
5. Relations between existing institutions on the one hand and the government on the other.
6. Methods of controlling the proposed mechanism.

7. Lines of business to be transacted by the proposed institution.

Under each of these main groupings a number of separate questions may be raised. These lead into a variety of detail which it would be unprofitable to pursue unless a general scheme of legislation were being worked out along a specified line.

METHODS OF PROVIDING CAPITAL

The methods of providing capital for such an institution proposed in the plans which have come forward within recent years may be enumerated as follows: (a) Subscription of capital by individuals and hence private ownership of the capital of the concern. This is the system largely followed in Europe; (b) Division of capital stock between private individuals and the government. This is the plan followed in some European banks and adopted in the organization of the first and second banks of the United States; (c) furnishing of capital entirely by the government; (d) division of capital stock between banks only, none but existing banks being allowed to hold stock in the concern; (e) obtaining of capital by "deposits" required to be made with the proposed institution by participating banks, or by the government, or by both. The plan of permitting banks, and them alone to subscribe to the capital stock of the enterprise is the proposal put forward in the National Monetary Commission plan.

Practically the same plan is pursued in the Muhleman central bank plan, except that this plan provides for the ownership of one-fourth of the capital by the government. The Fowler plan provides for obtaining the capital by the deposit system, already indicated. Of these different plans it may be said that they are not fundamentally different from one another. Whether the capital be contributed to an incorporated institution, by banks, which thus become stockholders, or whether it be supplied by the making of compulsory deposits, the result is practically the same, except in so far as certain questions affecting the legal status of the institution may be raised. These, however, have no necessary relationship to the question of banking as such. Whether the organization be called a central bank, a reserve association, or a federal reserve bank, or a board of deposit and issue, is a mere question of names. The fundamental question is whether the institution, whatever it may be, is to do a regular banking business, and is to do that business by the use of capital which has been supplied to it by individuals or institutions which expect to derive benefit therefrom, and to become, at least potential, customers, of the organization. In this particular, the choice of a method of getting capital is largely a

matter of expediency and of deference to popular prejudice. There can be no doubt that, abstractly speaking, the desirable plan, if such an institution is intended, is that of incorporating the concern, be it called bank or reserve association, or what not, and of assigning to it a regular specified capital of definite amount on the strength of which it is to do business. The variations in this plan are sometimes put forward as being intended to insure flexibility—that is, power on the part of the stockholders to withdraw readily,—and sometimes as being intended to avoid public prejudice. The withdrawal of the capital can, however, be provided for perfectly satisfactorily under the stock ownership proposition, while the question of popular prejudice is a matter of argument and discussion.

There is no reason why an institution which gets its capital by the deposit method, should be more amenable to proper control than an institution organized as a stock company. In some respects, the latter type of organization is more easily controllable than the former, since it would be subject to the generally well recognized principles of corporation organization and law.

RELATION BETWEEN ORGANIZATION AND BRANCHES

All three of the plans under consideration provide for branches and their separate organization. The National Monetary Commission plan has created fifteen branches. Subordinate to these would be district and local associations of banks. The Muhleman plan provides for the creation of eighteen banking districts, in each of which there would practically be a branch of the central bank. The Fowler plan provides for the creation of 28 bank note redemption zones, in each of which there is to be a board of control having supervision of each of the banks in that district. It also provides for what is called a "bankers' council," which is to exist in each bank note redemption zone, the chairman of the bankers' council to be also the chairman of the board of control of said zone. Thus it is seen that each of the three plans under consideration (and, it may be added, practically all other plans of the same kind) provides for a set of subordinate organizations which are to serve the several sections of the country. This merely amounts to a recognition that it is not possible, from a single head office, to do the work which it is proposed to entrust to the institution in contemplation. At this point, it may be noted that a serious question and difference of opinion arises, when it is sought to provide for a suitable division of capital between the different sections.

The National Monetary Commission plan and the Muhleman plan

would practically leave the several branches without a definite capital, permitting the central organization to determine what capital could be used by them or be available for them. The Fowler plan would practically leave the several zones or districts to determine their own capital, while the central organization itself would have a specified sum at its control as a result of the deposits made with it by the several banks in the way already indicated. It should be noted that an alternative to these plans would be to allocate a definite amount of capital to each district or branch and have the actual business done there, the central organization being either given a separate capital, or being nothing more than a board of control to oversee the operations of the banks in the several districts or branches.

RELATION TO EXISTING BANKS

The natural way of organizing such an institution as this would apparently be that of permitting individuals either to take up the stock by themselves, or to subscribe jointly with the government, then putting the concern into operation as an independent bank. This is the plan which is, at least fundamentally, followed by the European countries. It is admitted that no such plan could be adopted in the United States because of the opposition of existing banks which would be antagonistic to any scheme that would provide a great institution, vested with the power to compete with them in their own territory, either directly or through branches or branch offices. Secondly, most of the plans for a central bank that are now before the public provide that the existing banks or a section of them, shall become stockholders in the institution, thereby giving them whatever profit may come from it, save in so far as such profit is shared with the government. The Muhleman plan would allow all banks, both national and state, to become shareholders. The same idea is embodied in the National Monetary Commission plan. The Fowler plan confines the membership of the institution to national banks. As a result of the inclusion of state banks and trust companies as stockholders, the National Monetary Commission plan finds it essential to establish elaborate provisions governing the reserves and business of the state banks and trust companies, so far as they continue to be stockholders. This at once introduces a serious element of difficulty which is not found in the Fowler plan, because that plan is confined to national banks, which are under the direct control of the federal government inasmuch as they owe their charters to it. It is admitted by everyone that any organization that is thus provided for must be strictly a commercial and banking

organization. It is for that reason that the effort is made to introduce the methods of control of state banks and trust companies that have already been referred to. The difficulty in the confining of the membership of the concern to national banks is simply the opposition of state banks and trust companies. Theoretically, it is very desirable that membership shall be confined exclusively to banks which owe their charters to the federal government. There seems to be little doubt that if the other classes of banks should be included as stockholders, there would be serious, if not practically insurmountable, problems growing out of the fact that these banks are not under immediate control by the federal government, that the state legislation pertaining to them varies very greatly from state to state, and that the amount of their liability, the position of their stockholders, etc., differs widely.

RELATIONS WITH THE PUBLIC

Closely allied to the foregoing is the question whether the concern should be allowed to do business with the public at large. All of the plans here under consideration take the view that the business of the institution should be done entirely with the banks which have combined to organize it. This is on account of the desire to prevent the existing banks from being antagonized by the new enterprise. It is probable that, were it not for this consideration the provision would be made that commercial enterprises should be dealt with by the bank and its branches, but the necessity of safeguarding the existing banks against competition has led to the omission of this feature from the three plans here referred to as well as from most others of the same type. The effect of this situation is of course to compel individuals to do business as at present, with existing banks. So far the proposed institution becomes exclusively a 'bankers' bank, or bank of rediscount. The circumstances under which arrangements are made for doing business with the several banks vary somewhat. Thus, the National Monetary Commission bill would not allow the proposed institution to do business with any except the banks that were its actual stockholders. The Muhleman plan would require that only the government and the banking institutions which were its shareholders should do certain classes of business, while a few other classes of business, such as dealing in gold bullion and foreign bills might be done with individuals. The Fowler plan would confine the business of the institution entirely to the national banks which were members of the various redemption districts or zones. In choosing between these various schemes it may be said that the best results would be obtained if business could be

done, not only with banks, but with large concerns which wanted accommodation up to, or beyond, a certain point. This, however, seems to be out of the question, and as a second alternative, there is the proposal to confine the business to banks. There is no sufficient reason for limiting the operations of such a concern to those banks that are stockholders in or members of it, unless there is an effort to exercise a special control over the type of business done, by means of regulations imposed upon the membership. But this latter object can be attained in other ways, so that it may generally be stated that, should such an institution be created, it should do business with all banks, no matter whether they be its stockholders or not. It may be conceded that the refusal of permission to do business with individuals and corporations is practically necessary in the existing state of feeling among bankers.

RELATION TO GOVERNMENT

Practically all of the current proposals, including the three here studied, recognize the undesirable character of our present treasury and subtreasury system, and provide that the institution to be organized shall be holder of the funds of the United States. There is a difference of opinion between them as to the extent to which the new institution would actually supersede the United States treasury. Under the National Monetary Commission plan, the treasury would retain some very substantial functions. It would have to care for outstanding government certificates of various kinds, the greenbacks, etc., and it would have its routine work to do. Under the Fowler plan, provision would be made for the retirement of the greenbacks, and the Muhleman plan would retire not only them, but the gold certificates. Some other plans which have been proposed from time to time, would practically transfer everything except purely accounting operations and ministerial duties from the treasury to the proposed bank. It may be said that the dictates of sound banking theory are in harmony with the view that whatever is done in establishing a central bank or analogous institution, should include the transfer of all government balances to it, in order that they may come back into commercial channels as fast as they are withdrawn therefrom through the payment of taxes. It would be desirable to frame a provision on this subject in such a way that practically no money whatever would be held by the government as a result of current transactions. The question whether the treasury should resign to the bank the function of redeeming its outstanding obligations such as gold certificates and the greenbacks involves a much larger problem—namely, the retirement of the greenbacks and the dis-

posals of the gold certificates. These are really separate and independent questions that have no indispensable connection with the relation of the banking system to the country or the treasury. If it should be determined that greenbacks and gold certificates shall be retired, the task of performing the work may well be entrusted to a central banking mechanism, whatever it may be, that is thus created. Under these conditions, the natural step would be to transfer to the institution the trust funds held behind the certificates and greenbacks either at once, or in installments, preferably in installments, the new institution becoming the medium for effecting the retirement of these notes and presumably being entrusted with the duty of substituting notes of its own in place thereof. No serviceable judgment can be expressed as to the details of this phase of the task until a decision has been reached as to the abstract desirability and expediency of retiring the classes of government currency already referred to.

METHODS OF CONTROL

No phase of the subject has aroused more controversy than that which relates to methods of control. All of the three plans here in question are much taken up with the details of methods of control, the choice of directors and officers of the proposed institution, and the like. The National Monetary Commission plan provides for the choice of a controlling body or board in each of the local districts, and these district organizations elect the directors of the branches, it in turn electing the directors of the central organization. The Fowler plan provides for the choice of boards of control in the various zones and for the creation of "bankers' councils" in each of these zones. The boards and councils then elect the directors of the proposed federal reserve bank itself. The Muhleman plan provides for the choice of boards of directors in the districts and the shareholders in the several districts elect delegates to the general national meeting which is to choose the directors, the latter being chosen two from each district. Both in the Muhleman and the Commission plan the government is given a certain number of directors, while in the Fowler plan government participation is provided for by having as chairman of each board of control a deputy comptroller of the currency. The object in the elaborate schemes of control which are suggested in these various plans may be enumerated as follows: (a) to prevent large banks from gaining a control superior or inimical to that of the smaller banks; (b) to prevent certain sections of the country from getting control at the expense of others; (c) to retain a sufficient amount of government control to

insure effective public oversight and supervision; (d) to guarantee a due regard for the needs of all portions of the country and to secure a representation which would certainly make plain the character of the banking necessities of each section at any given time. The plans of control suggested in these three schemes are decidedly different from one another in each of the four particulars already mentioned, and are especially at variance in the relationship established between small and large banks. Of the three, the National Monetary Commission plan is far the more complex and would probably result in throwing a preponderating amount of power into the hands of the larger banks, although there is nothing in the plan that necessarily suggests a sinister scheme to give authority to "Wall Street" or financial interests. The Commission plan is not, however, a democratic type of organization, and its results would undoubtedly be to centralize control in a very high measure. This point will be more fully elaborated later in a separate discussion.

It may be said at this point that the desirable thing in any such organization is to assure as nearly as possible equality of representation and to prevent the possibility either of diversion of capital in favor of any interest or section and to prevent suspicion of control by an "inside" group.

CHARACTER OF BUSINESS

It is generally agreed that an institution organized on the lines already indicated should be limited to a rediscount business, but there is considerable difference with reference to the various plans proposed with reference to the character of operations that might be engaged in under this head. The National Monetary Commission plan provides for limiting the rediscount business to paper growing out of commercial, industrial or financial operations and would allow loans based on collateral only under rather rigidly limited conditions. The Muhleman plan is somewhat more liberal in this regard, while the Fowler plan is very much vaguer and less distinct with reference to what the proposed institution could do, although it might fairly be interpreted as conveying rather broad powers. The National Monetary Commission plan limits the paper which can be rediscounted to very short-term paper unless banks are able to secure the endorsement of the other banks in their local associations, in which case a somewhat greater latitude is to be accorded the paper which may be rediscounted. The importance of the provisions relating to rediscount is found in the following considerations: (a) The proposed concern would be valueless unless its

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operations were such that it could always supply aid by extending credit under proper conditions. This means a necessarily liquid condition of its assets; (b) If, however, a too stringent limitation be imposed upon the character of the paper to be accepted by the rediscounting power, the services of the concern will be too largely placed at the disposal of city banks and too little at that of country institutions; (c) if collateral loans are permitted, the danger is that funds may be drawn off into stock speculation, while if not permitted, many desirable and entirely proper rediscounts which could be successfully protected by a suitable use of collateral will be barred. (d) it is extremely difficult by any form of language to describe in a satisfactory manner the character of the "commercial paper" of any particular region, which is to be acceptable by such an institution. On the whole, the desirable limitations upon the power of such a concern will be found, primarily, in provisions which will prevent the drawing off of funds into stock speculation, and which will provide for a satisfactory and sufficiently stringent government oversight to insure that only proper undertakings are engaged in.

NOTE ISSUES

Thus far nothing has been said on the question of note issues, although that is one of the topics around which most controversy and discussion has centered in connection with banking and currency reform heretofore. Practically all of the plans under consideration agree in providing for issues of notes on a new plan, it being recognized that the existing note issue system is unsatisfactory. Fundamentally what is aimed at by all of them is the retirement of bond secured bank notes of the present type and the substitution of a new kind or class of bank notes. But this raises the further question, by whom such new bank notes should be issued. There is a difference of opinion as to whether the note issuing function should be transferred entirely to the central institution proposed to be organized, or should be vested exclusively in the banks, or should be shared between the banks and the proposed central institution. Many differences of detail also exist in reference to plans for retiring the existing bank notes and for protecting the banks which now hold national bonds against the risk of loss of such bonds due to probable curtailment in value resulting from the withdrawal of the circulation privilege now attached to them. This discussion may be pursued under several different heads.

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REASONS FOR RETIRING BOND SECURED CURRENCY

There are several important reasons for the retirement of bond secured currency. The one most frequently put forward is that bond secured notes are not "elastic." By this is meant that the necessity of purchasing bonds to be deposited with a trustee for the protection of note issues prevents banks from issuing these notes as freely and promptly as they otherwise would, while it also prevents them from retiring or contracting the notes as freely and promptly as would otherwise be the case. This is a perfectly sound consideration, and there is little or no disagreement at present among students of the banking and currency problem in the United States that the retirement of the bond secured notes is essentially necessary if success is to be had in restoring elasticity to the circulation and in making the national banking system really responsive to the needs of business. For that reason, every plan of currency or banking reform that has been put forward during the past fifteen years has contained as an important factor some provision for getting rid of the bond secured notes. The basic criticism on the present system of notes already indicated is reinforced by the fact that the supply of United States bonds available for use in protecting note issues is likely to be limited, as was the case of the panic of 1907. Then, the national banks were not able to enlarge their issues because of their inability to obtain further bonds, until they had been aided by the action of the government in issuing additional bonds for the very purpose of furnishing a backing for currency, notwithstanding that at that moment there was a very large surplus in the Treasury. Over and above this consideration has been the fact that the formalities and technicalities connected with the issue of bank notes based upon bonds have been so great and troublesome as to preclude the easy and prompt supplying of currency even when there were enough bonds in the market to furnish all the backing for notes that might be desired. This shows why, apart from the special and peculiar difficulties that attend anything of the sort, the substitution of bonds other than national for the national bonds now used will not help the situation. The only way to relieve the bad conditions that have developed in connection with national bank currency is therefore generally admitted to be the abandonment of the bond security plan and the introduction of something else in its place.

DIFFICULTY OF BOND HOLDINGS

The first difficulty in passing from the bond-secured system of note issues to anything that might be devised to take its place is the fact

that even if all had been satisfactorily arranged with reference to the new system, its soundness, etc., the difficulty of dealing with the bonds would remain. The act of March 14, 1900, provided for refunding the outstanding bonds into the two per cent consolidated debt, and these two per cent bonds were subsequently sold at premiums which once ran as high as eight or nine per cent and have regularly been two or three per cent or more. Partly as a result of general depreciation in the values of bonds due to rising prices and higher interest for capital, the national bond quotations have sunk until the two per cents are now at about par. The bonds have thus inflicted a loss upon their holders of about \$30,000,000 already and something like that sum has, according to the Comptroller of the Currency, been "written off" by the banks and must be regarded as one of the costs of carrying the note system at present in use. There is general agreement that if the circulation privilege were to be taken from the two per cent bonds, or, what is the same thing, if a new system of note issue were to be established which would practically displace the present system, the twos would deteriorate to a price not higher than 80. This would mean a shrinkage of one-fifth of the par value of the bonds and would inflict upon the banks an aggregate loss of nearly \$150,000,000. The infliction of such a loss, of course, would be exceedingly unjust, so much so that the banks would probably be successful in efforts to withstand the adoption of any such legislation, should it be seriously attempted. Alternative to this is the idea of providing for a refunding of the bonds. Experience, as well as computations made in the Treasury, indicate that three per cent is now about the level of the government's present borrowing power. The \$50,000,000 Panama bonds which were sold less than a year ago brought a premium of between two and three per cent, but three per cent interest without the circulation privilege represents nearly the level of interest that must be paid (in round numbers) upon any future issue which is expected to be floated upon an investment basis. In order to safeguard the banks against loss, therefore, a plan of refunding into three per cent bonds would have to be followed. The banks might be required to accept cash payment for their bonds at par and the new securities might be sold for what they would bring, or a flat exchange of three per cents for the old twos might be ordered. The latter would be simpler and the former would probably cost a little less. Either plan would entail an increase in the present interest burden nearly amounting to one per cent annually on at least \$730,000,000, or \$7,300,000 a year. There is no reason to think that the operation could be carried through more cheaply than

this, and of course a proposal to make such an increase in the expense of handling the debt always arouses sharp criticism and opposition. In order to meet this criticism and mask the real nature of the transaction, the National Monetary Commission plan provides for the refunding of the bonds, but directs that a tax equal to the increase in interest plus the amount of taxation lost through the retirement of the old notes (they being taxed at one-half of one per cent today) shall be paid by the proposed National Reserve Association on the whole value of the bonds which it takes over. The Fowler plan and the Muhleman plan provide for the refunding of the bonds in ways which vary somewhat but come to the same thing. Every plan thus far proposed from a serious source with reference to banking and currency reform looks to the ultimate retirement of the bond-secured notes and provides for the immediate or ultimate refunding of the bonds at a higher rate of interest than is now paid.

TEMPORARY ALTERNATIVES

Temporary alternatives for the retirement of the bonds are, however, proposed here and there. The most familiar and perhaps the most available plan of the sort is that which proposes to require banks to have outstanding a certain percentage of notes based on bonds before they become eligible to take out notes without bond security. This would mean that an inflexible volume of bank notes was kept outstanding or at all events that an inflexible volume of bonds was held by the banks to protect such outstanding notes in case they should be issued, and that whatever new form of currency might be provided for would come out in excess of or in addition to the basic volume of notes and bonds already referred to. The plan would partially destroy the possibilities of elasticity in the note currency system, but at the same time it would operate to keep up the value of the existing bonds for the time being. The question would then be whether the effort to sustain the value of the bonds in this manner during the remainder of their life was not too great to be compensated for by the saving in interest thereby effected. The general opinion of students of the subject undoubtedly is that this temporary method of sustaining the value of the bonds is undesirable, and that it is far better to recognize the facts in the case and take up the securities in such a way as to relieve the banks from any danger of further loss, the government bearing the increased interest charge and leaving the banks to turn in their securities at will. If congressional action to that effect can be secured, there can be little doubt that the best plan will be to make provision for a

straight refunding of the bonds without any attempt to mask the operation or to economize or recover the cost of it through indirection of any sort. The reluctance that has always been shown by Congress to do anything of the kind is, however, admittedly a very serious obstacle to success in disposing of the bonds and thereby to the actual solution of the first problem connected with any plan for changing from bond secured, to some other form of, currency.

METHOD OF NOTE ISSUE

What has been said thus far has been founded upon the assumption that agreement had been reached with reference to the method of note issue to be followed when once a plan for retiring the old notes and disposing of the bonds had been agreed upon. While no such agreement has ever been arrived at, it is true that substantial agreement has been reached with reference to the basis on which the notes that are to supersede national bank issues shall be put out. This should admittedly be the so-called asset currency basis. In this plan there is no special protection behind the notes, but they are placed upon the same basis as the other liabilities of the bank, save that in some measures they are given a prior lien on the assets to be exercised in the event of failure. A good many of the proposed banking plans also provide that there shall be a limitation of the amount of notes issued with reference to capital. "Not more than an amount equal to the total capital of the issuing bank" is the limitation most frequently followed in restricting the note issues of banks under the conditions referred to. This limitation has no special theoretical warrant, and has usually been applied simply as a concession to public opinion and in order to prevent some banks from getting the advantage of others in the circulation of their notes.

NOTES—BY WHOM ISSUED

Another phase of the note issue question is seen in connection with the problem by whom the notes should be issued. The current assumption is that in the event of the creation of any central or cooperative institution the note issue power now exercised by the several banks should be transferred to and vested in this new organization. That is the provision of the National Monetary Commission plan as well as of the Muhleman plan. The Fowler plan keeps the note issue function in the hands of the several banks which are joined together to create a cooperative mechanism. In favor of the notion of giving the note issue power to the central or cooperative institution is the argument

that if the issue of notes were wisely handled it would be more uniform in its management and less subject to danger of inflation and local abuse. Against this idea is the fact that the issue of notes would by such a scheme be made a monopoly to whose benefits the several banks could gain access only through the consent or good disposition of the institution vested with the power referred to. There is no reason in theory why even if such an institution were created, the power of note issue should not be exercised both by it and by the several banks. Assuming that there is no theoretical difference between the issue of the bank note and the granting of the credit on the books of a bank (ordinarily called a "deposit"), it is difficult to see why the full power of discount whether by the issue of notes or by the granting of such deposits should not be exercised by the several banks or why the power of rediscount by both methods should not be exercised by the central institution. European practice points to the policy of vesting the note issue power in the hands of the central bank and denying it to the other banks, but that is a situation which has grown partly out of past difficulties with note issues which would not now exist or at least could be avoided, and partly out of a misunderstanding of the identity of function of bank notes and credit deposits. This misunderstanding was much more prevalent at the time when the central note issue systems of the various European countries were first established, as seen, for example, in the case of the Bank of England.

IMPORTANCE OF NOTE ISSUE FUNCTION

There has been a tendency to overestimate the importance of the note issue function and to treat it as if it were the chief object to be attained in banking legislation. This idea may be attributable to the belief that "emergency currency" is what is needed in order to relieve panics and stringencies, whereas what is actually needed is fluid resources of some kind, whether notes or not. The belief that the notes are very important has also been stimulated by the experience in this country with clearing-house certificates which are often spoken of as if they were notes. The fact is that they are merely evidences that the banks that have gone into the clearing-house arrangement are willing to accept a credit substitute for money in settling their balances with one another. It remains true that the provision of a satisfactory note currency would be a long step in advance as compared with existing conditions, independent of whether such note currency was obtained through the intermediation of a central bank or cooperative institution or not, although it should be carefully borne in mind that

the provision of such a note currency would not necessarily solve completely the elements of difficulty which inhere in the existing banking system. With proper control and restriction it would, however, supply a means of obtaining additional circulating media in time of panic or stringency when there was a tendency to hoard money, and would to that extent relieve the danger of collapse due to inability to convert assets into fluid resources. It is therefore a cardinal element in currency and banking reform and should be provided for in any legislation that may be adopted, no matter whether such legislation be intended merely as a revision of existing law or whether it be framed so as to include a plan for providing rediscounts through a cooperative agency.

Committee's View

The analysis thus presented to the sub-committee was taken under advisement and constituted the basis of considerable detailed discussion and of further memoranda bearing upon individual points in which various members of the sub-committee were interested. By this time, however, it appeared that prior to the end of the session of Congress then in progress it would not be possible to obtain the active co-operation of more than two or three members. Congress was already disposed to disintegrate, in view of the approaching national campaign in which members themselves were directly concerned with their own political fortunes. It was agreed, therefore, that the analysis thus submitted should be regarded as the basis of further work and that taking it as a starting point a bill should be prepared whose purpose it would be to embody all of the valuable technical features which could be drawn from the preceding legislative proposals, basing the measure, however, upon a local non-centralized plan of organization which should insure so far as practicable local control over funds, throughout the principal economic districts into which the country might be regarded as divided.

CHAPTER VIII

THE FIRST DRAFT

Principles of New Legislation

Before any decision could be arrived at by the Banking and Currency sub-committee with respect to the direction to be given its practical work, it was needful to develop at least a tentative set of principles in order that the task of drafting a measure might proceed with regularity and with fair prospects of attaining a positive result.

During the late spring of 1912 at the informal discussions which had then occurred, it had been sought to obtain the opinion of sub-committee members in definite if informal expression.¹ As the outcome, the following general and tentative propositions were gathered:¹

1. The general notion of emergency relief or emergency note issue as a means of banking reform or as a basis for banking legislation is inadequate and unsound, and should be abandoned.
2. Whatever is done should seek to provide a permanent basis of banking organization, regularly functioning and regularly incorporated or established.
3. This basis of organization may well be modeled upon the experience of American bankers in their clearing house organizations, in so far as the latter have had to do with joint action for effecting interbank payments.
4. The framework provided by the Aldrich-Vreeland Act should be given due consideration both for its construc-

¹ No official record of these conferences was ever kept. The author, however, was present at practically all of them and noted down the conclusions then arrived at for his own instruction and information.

tive suggestions, where it provides any, and for its failures in practice as showing what not to do.

5. Data, expedients, mechanisms, and modes of procedure found in the various plans already before the Committee may be considered, and where needful modified and used. Indeed, if a desirable feature be found in any of the plans, that is a fact which should commend it rather than militate against it.
6. In general, the new bill should seek to provide for co-operative action on the part of the banks and should accept the principle of centralization under suitable government oversight and control.
7. The idea of guaranty of bank deposits has attained a hold upon the popular mind, and should be carefully analyzed for the purpose of determining whether in some sound form it may not be incorporated into the pending bill.

With these general and tentative instructions before him, the expert of the Committee was directed to employ the summer and early autumn of 1912 in the preparation of a draft measure which should be used as the basis of committee discussion in the autumn. There was informal agreement that in the event of defeat of the Democratic party at the autumn election the task of further study of legislation might as well be laid aside, while in the event of success the sooner the work was prosecuted the better.

Preparation of Tentative Draft

The tentative draft of materials in bill form for use in shaping the Federal Reserve Act was accordingly prepared during the period from June, 1912, to and including October, 1912, and was completed in the latter month. Mr. Wilson having been elected President early in November, with a Congress overwhelmingly of his own party, the outlook for legislation took on, to many eyes, an entirely new hue, and sundry persons, both in and out of Congress, who had hitherto been

indifferent or passive, began to manifest great interest in the banking and currency question. Among these were some of those who had been members of the Money Trust subcommittee of the Banking and Currency Committee.

Comparatively early in the summer of 1913 it had become evident that the section of the House Banking and Currency Committee which had been entrusted with the task of conducting the Money Trust inquiry was not altogether satisfied with the share of the work which had been assigned to it. Precisely where the dissatisfaction thus revealed originated cannot be exactly ascertained. There were, however, several indications of it and as a result a somewhat difficult situation was later created. Although the making of the Money Trust inquiry had been authorized as early as March, 1912, very little was done with the exception of "preliminary investigations" up to the middle of June, when Samuel Untermyer of New York, who had been appointed counsel of the Committee, placed on the witness stand Mr. Herman Sielcken of New York City for the purpose of interrogating him about operations in coffee, in which he had been assisted by various banking institutions. The cross-examination of Mr. Sielcken did not produce any very definite results, in fact hardly anything of novel interest, and the whole matter appeared to be a "flash in the pan." As it was then near the beginning of summer, agreement was reached to hold a few hearings in New York City and then to postpone further action until autumn. The New York hearings occurred between the dates of June 6 and June 13, 1912, and it was in connection with these that the growth of feeling in the Committee, to which reference has already been made, began to be exhibited.

Work of Organizations

Representatives of the National Citizens' League had been called to the witness stand and closely interrogated regarding the expenditures of the organization as well as with reference

to kindred matters.² Officers of the New York Clearing House were likewise examined and there seemed to be a general tendency to convert the investigation into a study of the attitude of the banks of the country toward currency and banking legislation, coupled with an analysis of the elements of such legislation. In fact, even as early as this Mr. Untermeyer had expressed in conversation with some of those who were called before the Committee the view that the investigation would ultimately develop into a study of banking reform legislation. Upon the return of Mr. Untermeyer from Europe in September of the same year it was stated that the Citizens' League had been asked to offer to the Pujo sub-committee a legislative measure embodying its ideas. It is understood that no such bill was ever supplied and it would appear that no measures were furnished from other sources; at all events if they were so furnished nothing was ever heard of them. As the autumn advanced, however, other overtures made on behalf of the Committee, either by Mr. Untermeyer or others, were reliably reported. After the presidential election had been held, Mr. Untermeyer became more than ever explicit in the announcement of his intention to direct the Money Trust inquiry along currency and banking reform lines.³

Division of Labor

The tendencies at work in the Money Trust sub-committee shortly became known to Chairman Glass of the Banking and Currency Legislation sub-committee, and he at once undertook to ascertain their significance. Chairman Pujo of the Money Trust sub-committee was plainly asked his intentions regarding the prosecution of the investigation and made it

² For a description of the League's character and activities, see Appendix at the end of this chapter.

³ In conversation with the writer, he plainly asserted that such was the intent of his Committee, and when attention was called to the fact that the resolution of the House under which he was operating expressly placed the question of banking and currency legislation in the hands of a different sub-committee, he responded that if such an obstacle existed it would be comparatively easy to adjust the legislative machinery in such a way as to rectify the defect immediately upon the assembling of Congress.

evident that he expected to adhere to the original lines laid down in the House resolution, observing the provisions for independent work on the part of the two sub-committees. The position thus taken by Chairman Pujo was so positive as to lead to a lengthy interview between himself, Chairman Glass, and Mr. Untermeyer, at which the latter set forth, in great detail, the advantages which would occur from the practical merging of the two branches of the investigation into one. His argument, however, did not suffice to convert either of the principals, and the outcome of the incident was a more clear-cut and definite agreement than had before existed, that the two divisions of the work should, in accordance with previous understanding, be separately carried on.

The fact that the discussion of banking and currency legislation had thus been definitely retained by Chairman Glass in the hands of his own sub-committee at once became known in banking circles throughout the country. Mr. Glass had no affiliations with any of the different banking groups between whom the country was divided. It proved impossible to ascertain exactly the position he would take. He had defeated Mr. Untermeyer and such elements in the Pujo sub-committee as had desired to take the banking and currency inquiry out of his hands. Possibilities of future danger were consequently perceived, and it was deemed advisable to begin countermining operations in order, if possible, to forestall any danger that might be incurred through the operations of the Glass sub-committee. The plan which was finally determined upon was that of arranging to supersede Mr. Glass in the headship of the Committee. In order to understand why this element in the program was developed, a brief retrospect of some political positions is, however, necessary.

Political Scheming

Chairman Pujo had had a desire to become a member of the United States Senate, and had conducted an earnest cam-

paign with that end in view. Having been disappointed he had made up his mind to retire from Congress, and had so announced himself, a successor consequently being elected in November, 1912. This meant that the chairmanship of the Banking and Currency Committee as a whole would necessarily pass to other hands. In previous years the principle of seniority in committee appointments in the House of Representatives had become so firmly rooted as to be almost unassailable. It had not only been observed with the utmost scrupulousness during the Republican régime but had been almost as closely followed after the Democratic party had assumed control of the lower chamber. Mr. Glass was the second member in seniority of rank in the Banking and Currency Committee, and upon the retirement of Chairman Pujo, the headship of the whole Committee would therefore naturally pass to him. At the same time, it was of course understood by all that no actual legislation could be seriously contemplated during the winter session of 1912-1913. Not only was the time too short at a winter session but the fact that the two houses of Congress were in the hands of different parties, while the national administration was about to be changed would in any event have put action out of the question. It was, therefore, undoubtedly felt by those who had taken the alarm that nothing need be feared from the winter's work in the sub-committee, provided that suitable arrangements were made for the appointment of a satisfactory chairman at the opening of the new session of Congress. It was, however, understood that immediately upon the opening of the new administration a special session of Congress would be summoned. The time for making the necessary legislative adjustments was thus very short. The problem was simply that of securing a combination which would effectually prevent the transmission of the chairmanship in the usual line of seniority and would transfer the succession to the leadership in some other direction.

Presidential Politics

It is now necessary to turn from the politics of the congressional situation as respects currency reform and to review the presidential side of the subject.

Ever since the Baltimore Convention there had been almost continuous speculation and discussion regarding the probable attitude to be taken by the Democratic party if successful in the elections, with respect to the banking and currency question. The evasive "plank" adopted at Baltimore had not been satisfactory to anyone. Open statements had been made in many quarters that the party either would have to avoid action on the subject, or, failing to do so, would become involved in serious internal struggles due to the supposed differences in point of view between Mr. Bryan and Mr. Wilson with reference to the subject. This doubt had been intensified by the apparent unwillingness of the President-elect, while still a candidate, to commit himself to anything on banking. Neither in his speeches nor elsewhere, so far as could be ascertained, had he made any reference to the situation or ventured to promise or forecast a policy. Private organizations which made efforts to "reach" Mr. Wilson and obtain an interview with him had been totally unsuccessful, the candidate either failing to answer communications on the subject or otherwise steering clear of the representatives of the various interests.

Early in the autumn of 1912, New York bankers became considerably worried by the silence of the Democratic candidate. They were now convinced that Mr. Wilson would be elected, owing to the sharp division of his opponents and the consequent "split" in the party support on the Republican side. This made it in their opinion more than ever urgent that they should know what was going on in Mr. Wilson's mind and they consequently despatched to Princeton a New York real estate operator who had been conspicuously active in behalf of the Wilson candidacy. He was instructed to inquire of Mr.

Wilson what would be the latter's position, if elected, with respect to the Aldrich bill, the legislative project in whose behalf the New York bankers had already disbursed so largely of their wealth. If this enterprise was expected to be successful it must have been an extreme disappointment. Mr. Wilson merely returned the somewhat Delphic response that he thought "the Aldrich bill was probably about 60 or 70 per cent correct but that the remainder of it would need to be altered." As he took pains not to specify which provisions were included in the 60 or 70 per cent thus approved, the answer was far from satisfactory to those who had sent a representative to Princeton; yet there was a suggestion of hope in the response which led them to continue in the belief that something might yet be accomplished.

Wilson Requests That Work Begin

The favorable outcome of the November elections did not serve to make Mr. Wilson more communicative to the outside world, nor, so far as could be ascertained, did he, during the month of November, unbosom himself as to currency and banking to any of the group which immediately surrounded him. When, however, Chairman Glass had, as noted in a previous chapter, brought his committee to the consideration of plans for the ensuing winter, he was immediately met by the suggestion on the part of some that it would be unwise to proceed with active measures unless assured that the new administration desired to have the subject dealt with soon after the fourth of March. Chairman Glass therefore addressed to the President-elect a brief inquiry with reference to the policy to be pursued, and after some delay received an answer to the effect that Mr. Wilson believed that the currency and banking question must form an element in the action of the new administration and that work should be proceeded with. This so far as known was the first occasion upon which a definite expression was received from Mr. Wilson, and even

in this letter there was no hint of the exact line of action to be pursued.⁴

Demands of Committees

Further meetings of the sub-committee developed a strong disposition on the part of the members to inquire as to the probable action of the President-elect, and Chairman Glass therefore determined to arrange an early interview with Mr. Wilson.⁵ The meeting took place at Princeton on the 26th of December and on that occasion Mr. Wilson's policy was indicated with probably greater fullness than on any preceding occasion. After conversation had developed in general terms the character of the bill which had already been mapped out and the work that had been tentatively undertaken by the Committee, Mr. Glass asked for a statement of Mr. Wilson's views, inquiring particularly whether the bill as outlined was in accord therewith. The answer was a somewhat vague and general expression of approval of the work already done, accompanied by the positive inquiry, "What have you done in regard to centralization?" Mr. Glass responded by enumerating the various powers bestowed upon the Comptroller of the Currency, while the writer himself called attention to the fact

⁴ The letter ran:

WOODROW WILSON
88 W. State St., Trenton, N. J

November 14, 1912.

My dear Mr. Glass:

I warmly appreciate your letter of November 7th. Letters descended upon me in such a flood that it has been impossible even to sort them according to their importance, and therefore I have just turned yours up from the pile too late, alas, to arrange for an interview with you before I go away to Bermuda on Saturday.

I shall seek an opportunity as early as possible after my return to commune with you, because the question of the revision of the currency is one of such capital importance that I wish to devote the most serious and immediate attention to it.

It is very delightful to know that I am going to be associated with you in the work at Washington. I shall look forward to it with genuine pleasure.

Cordially and sincerely yours,

(Signed) WOODROW WILSON.

Hon. Carter Glass,
Lynchburg, Virginia.

⁵ On December 23 Mr. Glass wrote:

"It seems to me that should we reach an approximate agreement with Mr. Wilson as to the salient features of Currency Legislation, it would be extremely desirable to get men like Hepburn, and Forgan and, indeed, as many of those who appear at the hearings as we may be able to persuade, to speak strongly in favor of the points upon which we may agree. To do this, it might be well for us to have talks beforehand with some of these gentlemen."

that a very marked degree of centralization would be obtained by uniting the banks in the several proposed districts under a consolidated type of organization subject to general federal oversight. That such a general central organ of the proposed banking system should be assigned very broad and inclusive powers was the decided view of the President-elect. As to the policy to be pursued during the new administration, he definitely indicated a desire to include the banking question from the very outset, safeguarding this disposition only by a general expression indicating a determination to be guided somewhat by circumstances.

Early Proposals

The change in point of view to which some political minds found themselves subject during the winter of 1912-1913⁶ is easily explicable in view of the position assumed by the President-elect. From being an unpopular subject cursed with a political tabu, banking and currency shortly became a popular fashion among politicians. The greatest curiosity seemed to be felt with regard to the contents of the bill which, it now began to be known, was being shaped by the sub-committee on Banking and Currency and had been discussed with the new Executive-to-be. Almost every imaginable expedient was resorted to for the purpose of finding out what the proposed measure contained and how it would affect existing banks.

It is worth while, therefore, to sketch at this point in its main outlines this earliest form or draft of what was later, to become the Federal Reserve Act. The considerations which underlay it have already been indicated in Chapter VII. The conclusions, based on these considerations, were as follows:

Local Banking Units

In a general way the new bill at the time it was submitted to the President-elect at Princeton in December, 1912, was

⁶ See p. 2 ante.

based upon the idea of local banking and currency organization. It took a step beyond the clearing house association plan and of course beyond the Aldrich-Vreeland proposal of national currency associations, by providing for the actual incorporation of local reserve banks which should represent the banks of the community in which they were situated. As to the number of these banks, it adopted no dogmatic view but provided in general terms for a permissive organization which would have allowed one at each already existing reserve city if necessary. The Aldrich bill, it will be remembered, had provided for a head office and 15 branches each to be located in a district of its own. But underlying this organization with 16 offices was provision for a great many "local associations" in which the banks would have been permitted to join. As the Federal Reserve Act was finally drafted it provided for a Board or head office at Washington with 12 banks each authorized to establish branches in its own district, while within the first eight years of the system a total of 23 branches was thus organized making 35 banking offices outside the Board. Had an office been placed at each reserve center to start with, there might have been a maximum of some 48 to 50 such establishments as soon as the bankers desired to create them.

Full Powers Bestowed

The powers bestowed upon the local organizations or reserve banks as they were later called were intended to be full banking powers including discount, deposit, and issue and in order that the banks might be enabled to carry on their business successfully, it was proposed to give them in contradistinction to the Aldrich bill and to other earlier measures, the open-market authority and the power of dealing with individuals which most European central banks possessed. As to the question of relations with the individual banks the bill left open for later determination the question whether membership should be absolutely compulsory within a specified time or

not. Note issues were to be provided for upon the so-called "asset currency basis," being protected dollar for dollar by actual commercial paper received by the reserve bank for discount and being thus limited in volume to the total amount of such commercial paper brought to them. These notes were not to be at any time a reserve in the vaults of any bank and every effort was to be made to insure their prompt redemption.

In order to bring national banks into the system and to have them feel that it was an immediate source of advantage to them, the bill proposed to broaden their powers of lending upon landed security (farm land) and to enable them to adopt a more liberal policy with respect to time deposits. Various other provisions were also made to render their membership attractive and they were granted the power of accepting bills on time. This, however, was limited to bills made in foreign trade and to a specified proportion of capital. The whole plan was intended to encourage the consolidation of the national banks into a single system with a view to bringing about more harmonious and unified operation and more effective handling of banking business. It was intended that the reserve banks should be institutions functioning regularly, dealing primarily with their members, but to such an extent as might be deemed essential, engaging in actual loans to individuals or purchases of paper from them after the fashion of the Bank of France.

Auxiliary Sections

Along with this bill were drafted certain subordinate or ancillary sections or provisions which were intended for discussion with the President in order to ascertain how far he would think it wise to go. These were as follows:

1. A plan for the immediate and compulsory transfer of all reserve balances then held in reserve cities to the new reserve banks—subject of course to such short-term delay as might be considered necessary to avoid discomfort or embarrassment to the various institutions.

2. A plan for a central or head office situated at Washington and to be under the direction of representatives of the several reserve banks co-operating or collaborating in the central management of the system. This office was to be without capital or resources and was to possess the general powers of supervision, regulation, control, and, when necessary, interbank rediscount.
3. A plan for the establishment of an inclusive exchange system calling for the collection and crediting of the proceeds of checks at par. It was believed that this plan when carried out effectively would result in correcting the clearing house evils which were then under investigation of the Money Trust Committee and that the plan could honestly be put forward as a means of correcting the faults that had been complained of in the existing structure of financial organization in such places as New York.
4. A plan for the establishment of a deposit guaranty fund to be set in operation under the direction of the new federal reserve system and intended to meet the demand which it was believed was strong within the Democratic party for the protection of bank deposits.

Distinction from Aldrich Bill

As distinguished from the Aldrich bill in general the new proposal, whether with or without the ancillary suggestions, was intended to be a simpler, more direct type of banking organization going back to the various proposals which preceded the Aldrich bill and tracing its descent directly from them and the clearing house associations rather than through the Aldrich plan itself. The object was to provide for local or home control of the rediscounting units instead of granting centralized control. The scheme sought to furnish as much of a local field as possible for the use of local funds while at the same time providing for possible relief to be drawn if necessary from a central source. By way of correcting exist-

ing evils it went to the heart of the matter by seeking to end the system of redeposits, by providing for the retirement of the national bank notes, the redemption of the 2 per cent bonds, and the issue of new notes to take their place, while at the same time it undertook to terminate the collection evils of the day by the positive plan of constituting the reserve banks as clearing houses.

Effect of Princeton Interview

The Princeton discussion with the President-elect did not have many immediate results, so far as details were concerned.

The interview, however, did have some very important consequences. It indicated plainly that the President-elect was deeply interested in the banking and currency question and was ready to go as far as was necessary to bring about genuine reform. It showed that he was desirous of effecting a substantial degree of centralization, although heartily maintaining the concept of local self-control. Above all it gave ground for the opinion that he was ready to incur the opposition of the vested interests so far as was necessary, and if after due study it should appear desirable to go to the length of transferring the reserve deposits at once or in the near future, the President was willing to support it. While not specific in his conception of the kind of centralized control which should be developed, or, as he expressed it in the Princeton interview, the "capstone to be placed upon the structure," it appeared probable that he would favor an organization designed to control and supervise and that he felt no partiality to the idea of a central organization vested with commercial powers—in other words, a central bank of some kind. He recognized the fact that such an organization was politically impossible even if economically desirable, and that what was to be sought was the provision of those central banking powers which were unmistakably desirable and the elimination of those central banking powers which had caused danger in the past.

Second Step

The Princeton interview must be regarded as the second step of fundamental importance toward the making of the Federal Reserve Act—the first having been taken in the work of the Committee which gave rise to the drafting and formulation of the outline already described and its presentation to the President-elect. Work was immediately begun upon the presentation of a definitive draft of the Federal Reserve Act (see Appendix I) and the material which had been taken to Princeton and laid before the Executive was speedily woven together into a completed measure.⁷ This bill assumed form about January 15, 1913. It was the first complete draft of the Federal Reserve Act and it embodied the entire original plan which had been taken to Princeton together with the provision for a central body or reserve board, the early and compulsory transfer of deposits from reserve city banks to reserve banks, and the establishment of a deposit guaranty system—the latter, however, limited to a plan for the part payment of depositors of failed banks up to the estimated value of the assets of such banks. Omitted from this draft of the Federal Reserve Act were the plan of an exchange system or partial collection and a number of minor features later to be introduced as the measure progressed.

⁷ On December 29 (1912) Mr. Glass wrote the author (in part) as follows:

We should make the alterations that you and I have talked over and should so alter certain sections of the bill as to meet the tentative views expressed by the President-elect—that is if you understand what they are. You will recall that he would take away from the individual banks the right of issue; but was disposed to compromise on my suggestion to lodge the right of issue with the divisional reserve bank instead of centralizing it at Washington. As I recall he also took kindly to the suggestion that there should be no inducement for the country banks to keep money deposited in New York beyond their actual needs for exchange purposes and that, therefore, it would be well not to permit payment of interest by banks on bank deposits. Then there is the matter of divisional reserve bank organization. I mean the method of appointing directors and the character of men who are to direct. We shall seek to hit upon some distinction between “bankers” and “business men” perhaps joining the former as men whose “chief business” is that of banking.

I do not get the impression that Mr. Wilson at this time is opposed to the guarantee of deposits. I have no doubt, however, that great pressure will be brought to bear to put him against that feature of the bill; but I am disposed to insist. Very likely you will recall my remark that, speaking for myself, I would cheerfully go with the President-elect for some body of central supervisory control, if such a body can be constituted and divested of the practical attributes of a central bank. In my judgment this is the point of danger. This is where the bombardment will be directed. If we can devise a superstructure or, to use Mr. Wilson's phrase, “a capstone” for the plan we have as it shall be revised, it would be well to be prepared for that emergency.

Subsequent History

It seems convenient at this point to give for the purpose of facilitating the work of those who choose to follow the development in detail a brief forecast of the various forms which this measure later assumed. A revision of the measure, herein usually referred to as the "second draft," was prepared as a result of the hearings which occurred during January and February before the Banking and Currency Committee (see Chapter IX) and of the discussions which accompanied them. This form of the measure was made ready at about the expiration of the short session of Congress. A revised draft of it was placed in the hands of the chairman of the Committee soon after the opening of the new administration.

A new form of the measure, herein usually referred to as the "third draft," was prepared during the months of March, April, and early May as the result of detailed reading by the Secretary of the Treasury in conjunction with the chairman and expert of the Committee. This draft was finally reached as the result of much shifting and changing from day to day and eventually came back to a position not far from its original form—practically all the changes recommended by the Secretary of the Treasury being found impossible and in most cases being withdrawn by him at his own instance. A still further revision was prepared early in June and embodied the concessions subsequently made to Mr. Bryan and later to be indicated at some length. This bill may be referred to as the "fourth draft" and was the form in which the measure was actually introduced in the House of Representatives in printed form. It was this fourth draft which was presented to the public and constitutes the form in which the Federal Reserve Act first became known. This measure was worked over by the House Banking and Currency Committee, modified, and reported to the House of Representatives, the bill as thus reported (after changes in caucus) being the "fifth draft." As passed by the House of Representatives the measure contained no material

changes and the bill as thus enacted may be regarded as identical with the fifth draft. The measure then went to the Senate Committee, was worked over in that body, and reported in a greatly changed form to the Senate itself. This form may be regarded as the "sixth draft." On the floor of the Senate considerable changes were again made, the bill as finally adopted by the Senate thus being entitled to a separate enumeration as the "seventh draft." Referred to conference Committee, the fifth and seventh drafts (House and Senate bills) were then harmonized and united, the eventual product being adopted by both houses as the Federal Reserve Act—the "eighth draft" in the series of successive proposals. This draft, as will later appear, was not greatly different from number 5—the House bill.

APPENDIX TO CHAPTER VIII

NATIONAL CITIZENS' LEAGUE

The activities of the National Citizens' League had at the time when the Glass bill was first initiated in the autumn of 1912 been in progress for something less than a year. The organization purported to consist of citizens interested in the promotion of sound and safe legislation on the banking and currency question. Exactly what its membership may have been could not perhaps be fully stated, but it developed a large paper organization practically throughout the entire United States with local organizations in the several states. It was primarily supported by the bankers of the country and, according to common understanding, the cost of the enterprise was divided among the banks somewhat in proportion to their clearing-house operations. As to the origin and purpose of the undertaking, a booklet issued soon after the establishment of the League became known gave an official description of it.

"As a result of the Panic of 1907," said the Citizens' League, in this pamphlet entitled "The Origin of the League," issued in Chicago in 1912, "the country became concerned for the commercial safety of its future. This anxiety so pressed upon Congress that the Aldrich-Vreeland Currency bill of 1908 was passed." Later the National Board of Trade at a convention held in Washington adopted resolu-

tions favoring a measure of banking reform and determined to devote one day at its annual meeting in 1911 to a business men's monetary conference. This conference was held just after the plan of the National Monetary Commission was published, and "adopted resolutions which ultimately led to the creation of the National Citizens' League." A committee was created which held a conference in Chicago, April 26, 1911, and "agreed that the responsibility of creating a national organization should be left with the business men of Chicago who should conduct a nation-wide campaign from their city." Later "the new movement was initiated by the Chicago Association of Commerce" and at a meeting shared in by that body's board of directors, a resolution was passed appointing specified men "to form a National Citizens' League." In speaking of the work of this organization the pamphlet in question stated that "it remains for the National Monetary Commission to make its final report in the form of a bill," but there was no express statement as to whether the League would favor that bill or not, beyond the remark that "the League as yet has no legislative proposal of its own."

This description, however, was obviously incomplete from many standpoints, and particularly so as regards the real location of the power behind the enterprise. As to this there has been much speculation and difference of opinion, but perhaps the most definite account of it was furnished in a publication known as "Chicago Commerce" (Nov. 8, 1912), which was the accredited "house organ" of one of the leading members of the League then resident in Chicago. According to this publication, the original arrangements upon which the League had been developed were somewhat as follows:

"An interview given out from the New York branch (of the National Citizens' League) and published jointly with the report of the meeting (of the general organization of the National Citizens' League) indicated New York's displeasure with the conduct of the League. When the nation's business sentiment was preparing to crystallize in a banking reform movement *it was at New York's urgent solicitation that this important and difficult service was accepted by Chicago, not from choice but as a public duty. New York did not hesitate to pass the big task on to Chicago and agreed to the form of control as well as the officers selected.*"

CHAPTER IX

TESTING PUBLIC OPINION

The House Hearings

The next step in the process of definitely preparing the new legislation was now seen to be that of ascertaining public opinion, and of comparing the draft which had already been made with the ideas of all those who were in a position to express an influential opinion with regard to it.

The customary congressional method of carrying on such investigations is that of holding "hearings"—a plan full of defects and unlikely of itself alone to produce anything of merit, but hallowed by custom and possessing a strong hold not only upon the congressional but also upon the general public mind. At the very outset it had been proposed by some members of the Committee that such hearings should be undertaken. There may have been some who regarded the step as merely one way of postponing or avoiding action until something new should turn up; others may have felt that in this way the work of the Committee would be more definitely advertised to the world and that public opinion would assume a more concrete shape with reference to the undertaking at hand while still others, possibly, believed that new light would be thrown upon the general subject in the course of the taking of testimony. It was therefore tentatively resolved to undertake hearings for the purpose of testing public opinion in the way already indicated.

One of the points raised at the conference with President-elect Wilson at Princeton on December 26, 1912, had been whether he had any objection to the presentation of the bank-

ing question at hearings to be held during the coming month of January. Mr. Wilson had expressed mild approval of the proposal, although urging that no announcement of intent or commitment to any given plan be allowed to occur.¹ It was evident that such hearings were essential not merely for the sake of the information to be obtained but also, as facts later showed, because of the politics of the situation. The hearings would have been unavoidable as a concession to custom, even had it been clear that they would yield no information.

Committee Difficulties

An element of difficulty had had to be encountered in this connection. Some members of the Committee who had not previously participated in the deliberations had begun to show a disposition to press forward with the familiar types of Democratic party legislation on banking and currency. Two such proposals or elements of the program appeared to be particularly troublesome—the desire to provide in some way for an issue of greenbacks or government legal tender paper currency, and the desire to include in the new legislation provision for a guarantee of member bank deposits. Both ideas were recognized by Chairman Glass as likely to endanger the whole success of the project and both were admitted by their proponents to be contested phases of the legislation which could be introduced, if at all, only after a very severe struggle with the conservative Democrats of the country. It was never the disposition of Chairman Glass to attempt dogmatically to shut off discussion on any phase of banking and currency and in the preliminary consideration of the proposed new bill which

¹ The author directly inquired of Governor Wilson, at the meeting in Princeton already described—whether, in his judgment, the holding of the hearings was wise and had his sanction. It seemed evident when the question was put that the President-elect had devoted some thought to the subject and that there was at least doubt in his mind as to the desirability of the proceeding, although this of course was merely inference. Mr. Wilson, however, said that in his judgment the hearings might well be proceeded with, although he added that they should be employed for the purpose of ascertaining opinion on the subject—meaning by this, apparently, that nothing should be said or done that might be taken to commit the party then in power to any particular measure or type of legislation.

took place during November, 1912, it was agreed that those who were disposed to do so should draft their proposals in definite form and submit them to the chairman for incorporation into such bill as might be prepared if he thought fit to do so. It was further agreed that at the hearings that had been proposed witnesses might be introduced and questions asked with a view to developing the facts bearing upon legal tender note issues and deposit guarantees in order that all available light might be shed upon both questions. In fact a substantial percentage of the discussion at the hearings did turn about these two contested matters. Neither of them, however, made its appearance in the preliminary measure which, as just seen, had been shaped for presentation to President-elect Wilson

Co-operation of Members

There had been some doubt on the part of a number of members as to whether the hearings would be acceptable or not, it being the feeling of many that the head of the new administration would probably prefer not to have the hearings pressed inasmuch as they would tend to concentrate public attention upon the banking question, and would therefore be likely to produce an unnecessary amount of anxiety or irritation in advance of a definite announcement of the policy of the new administration. When with some apparent hesitation he indicated, however, that he thought it would be well to conduct them carefully for the purpose of testing public opinion, the moderate approval of the plans granted by Mr. Wilson in the language already referred to insured their completion. When the doubtful members of the sub-committee were informed of the position assumed by the President-elect they at once withdrew all objections and indicated a disposition to co-operate.

Proposed Scope of Hearings

As is usual in such cases, the question strongly presented itself: Who should be allowed to have a voice at the series of

hearings? It has been not unusual in legislative procedure so to manage a series of hearings as practically to give opportunity to but one side in a contested case, opponents remaining either totally unheard or, at best, being given but a poor chance to register objection. Probably few persons who have taken the trouble to examine the congressional hearings of the past few years with reference to banking and currency have failed to notice the very great preponderance of purely professional banking witnesses over others. It might be asserted that this was a natural and proper situation, inasmuch as banking is a technical occupation and since, consequently, few except bankers would be in a position to discuss with intelligence the details of legislation bearing on the subject. This view has been thoroughly exploited in connection with the tariff question and has given rise to two distinct schools of thought, one believing that legislation is peculiarly the province of those who are to be directly affected by it, the other holding that the general public effects of legislation give to the community the right to share, at least in a general way, in selecting the methods and plan of procedure in any given case. Whether rightly or wrongly, it was determined that the new hearings should, if possible, be moulded upon this second view of the situation; and it was consequently determined to consult not merely bankers and so-called financial experts, but also business and labor leaders, academic students of currency and banking, representatives of organizations of various kinds, and persons whose calling naturally brought them into contact with considerations which should have weight in the framing of legislation. Inasmuch as the Committee was not in position to pay the expenses of those who might appear, it was likely to be free of the usual cloud of witnesses who frequently seek to present themselves on such occasions. It was agreed to make the hearings an opportunity for testimony on the part of all elements in the community and to send out letters of invitation not merely to bankers and those affiliated with them, but also

to all other significant elements in the population. Thus the hearings would constitute a true test of public opinion.²

The Call for Witnesses

Acting upon this view, a series of letters was framed, for use with a particular group of persons and designed in each case to arouse the attention of the individual to whom it was addressed by laying stress upon the significance of the legislation in its bearing upon his particular class of business. Thus, for example, a letter was prepared for transmission to farmers' organizations, another for transmission to heads of business and industrial organizations, another to bankers, another to individuals and currency experts, and so on. In this way, the foundation was laid for the preparation of a select list of witnesses who should represent different sections of public opinion and who it was hoped could be depended upon to inform the Committee of the wishes of the community with regard to the whole subject.

Those interests which seemed to be directly concerned in the legislation and were accordingly invited to attend included chiefly the following:

Agriculture, represented by officers of granges and other organizations.

Bankers, represented by the Chairman of the Currency Commission of the American Bankers' Association.

Credit men and credit experts, represented by the officers of the National Association of Credit Men.

Labor, represented by the American Federation of Labor and other organizations.

Capital, represented by the National Association of Manufacturers and other associations.

Former financial officers of the government, represented by a former Secretary of the Treasury and others.

² The intention was to endeavor to secure from the business, labor, and agricultural elements in the population so explicit a declaration of opinion as to make it certain that during the later progress of the bill, if any should make its appearance, there would be none of the usual attempts to reflect upon the measure on the ground that it had been framed without the knowledge of those affected and without consultation with them.

Associations and persons interested in banking legislation, represented by the National Citizens' League and by various individuals.

Domestic and foreign experts, represented by various bankers, writers, and others, including an eminent Canadian banker.

Lack of Interest

The sending out of the prepared letters of invitation to appear before the committee was naturally the next step in the process of arranging the hearings, but a considerable disappointment was now to be met. It was almost immediately apparent that the bulk of those to whom the letters were addressed possessed either no interest whatever in the situation or, at best, only a very faint one. Some entirely failed to answer the letters; others merely sent a brief declination, usually by the hand of some subordinate. This was notably true of the retail and wholesale organizations of business men and of the manufacturers—among the latter, the National Association of Manufacturers manifested almost a total indifference to the whole subject. Neither the retailers, wholesalers, nor manufacturers, however, matched in their lack of interest the labor organizations. Despite the constant assertions in years past that the interests of labor had been disregarded, or never consulted when currency and banking legislation was being studied, none of the labor leaders now addressed, including Messrs. Gompers and John Mitchell, exhibited any disposition whatever to participate in the hearings. Indeed, it was difficult to get even a response from them, although special efforts were made in order that, should the question later arise, it could be truthfully stated that every effort had been made to get their views.³ The most willing response was obtained

³ It was exceedingly disappointing to find that business men of the community were reluctant or indifferent, while the labor element practically disregarded the whole subject. Not only did the heads of important manufacturing, wholesaling, and retailing organizations fail to answer the letter of invitation sent to them but others while sending a formal reply indicated in the wording employed so complete an indifference towards the whole undertaking as to suggest that the commercial appreciation of the need of banking and currency reform was almost non-existent. The labor men adopted practically the same attitude and neither John Mitchell nor Samuel

from the bankers themselves and from organizations which had already been interested in reform legislation; such, for example, as the National Association of Credit Men, the National Citizens' League, and others. All of these promptly indicated a disposition to accept the invitation extended and to present their views. A very similar interest in the subject was exhibited by individuals who possessed familiarity with currency and banking and were invited to express their ideas on the ground.

Attitude of Bank Organizations

Yet even this degree of interest in the hearings was not elicited without some difficulty. There appeared at the outset to be at least a possibility that the bankers would fail to share in the investigation. So indifferent had they appeared that it had been deemed wise to establish communication personally with some of those who were responsible for the work of the American Bankers Association in regard to the currency question. A first approach was made to Mr. A. Barton Hepburn, of New York, then chairman of the so-called "Currency Commission" of the American Bankers Association, he being asked whether he would be inclined to participate in the hearings on behalf of the body he represented.

Currency Commission Proposal

It seemed at first as if Mr. Hepburn was but mildly interested in the situation. He indicated considerable disbelief in the chance of definite action, referring to disappointments in the past, to the work of the Money Trust investigation then in progress, but finally undertook, as a matter of duty, to communicate with some of his colleagues. The result of this communication was a proposal to hold a meeting of the Cur-

Gompers, both of whom had been asked to be present and express themselves, either accepted or returned so much as a formal answer, the utmost ever obtained from them being a curt note from Mitchell, or someone representing him, to the effect that he would refer the subject to a labor organization meeting which he was shortly to attend. Nothing was ever heard from the organization in question.

rency Commission in Washington at the time of the hearings, for the purpose of expressing united opinion on the whole subject. This suggestion was, however, obviously undesirable. It was plain to Chairman Glass that the holding of such a meeting would not result in developing definite and detailed information but would lead merely to the expression of a formal opinion, probably nothing more than a reiteration of the support already given to the Aldrich or Monetary Commission bill.⁴ This idea was strongly represented to Mr. Hepburn, and it was urged upon him that what was desired was simply the presence of representative and intelligent bankers, not necessarily representing the American Bankers Association or any other association in a formal way, but bankers able and willing to discuss the question of banking legislation upon their own responsibility.

Change of Bankers' Plan

Mr. Hepburn and those associated with him ultimately accepted this view of the matter and the proposed meeting of the currency association was not summoned, but Mr. Hepburn himself and several other representative and leading men consented to attend the hearings in their individual capacity and

⁴It was about this time that the author wrote Mr. Glass from New York as follows under date of January 18, 1913:

"I endeavored yesterday to find out so far as possible the condition of affairs with reference to the attitude of the bankers toward the proposed legislation on the banking question. After some inquiries I learned that Mr. Festus J. Wade returned here immediately upon leaving Washington and went into consultation with Mr. Hepburn and other bankers as regards the 'situation' in Washington. After discussions lasting a couple of days it was determined that the best policy for them to pursue was to chime in with the Committee or with what they supposed the Committee was inclined to do and to support a 'divisional' or 'regional' reserve bank bill, endeavoring, however, to have it made as 'strong' as possible. It was also decided to have a meeting of the Banking and Currency Committee of the American Bankers Association convene either in Washington or Chicago, probably the latter, at an early date for the purpose of going over the situation and if possible getting them to 'switch' to the plan suggested by Hepburn and Wade. Wade on returning here said very little about the testimony he offered before the Committee in favor of a Central Bank plan but laid the stress upon the talks he had had with yourself in private. After he had got through with his conferences with Hepburn and others it was decided that he should go to Chicago and should carry the word to Mr. Forgan in order that the latter might if possible be prevented from stating to the Committee too strongly that he would not stand for anything except a central reserve plan, as it was feared that should he do so, he would commit himself and in a measure the Bankers' Association, once more to the central reserve plan thereby making it harder to 'back down' than it otherwise would be."

to express their ideas regarding the whole subject. Among those who testified were Messrs. Hepburn, Reynolds, Wexler, and a number of others fully capable of presenting the ideas prevailing among the larger bankers of the country. It was, however, recognized that a considerable opposition of interest, and to some extent of feeling, existed between the large and small bankers of the country. Consequently special effort was made to secure the attendance of some representative bankers known as the heads of sound but small institutions. Mr. Andrew J. Frame, of Wisconsin, and others were included in this category, and actually presented their evidence. Due to a desire also to obtain the views of men who had in the past been charged with responsibility for administration and legislation some ex-Secretaries of the Treasury and former legislators had received letters of invitation. Ex-Secretary of the Treasury Shaw presented evidence and Hon. Charles N. Fowler, formerly chairman of the House Committee on Banking and Currency, likewise appeared. In other cases where invitations were sent, no success was experienced in securing attendance. By way of obtaining the views of foreign bankers an invitation was extended to one or two men of prominence in Canada, and Sir Edward Walker, president of the Canadian Bank of Commerce, visited Washington and gave his evidence. The number of those who were disposed to present themselves for consultation was ultimately considerable and the result was a series of hearings lasting from January 7 to February 17, at intervals, and producing a large volume of printed reports.⁵

Views of Financiers

The Committee deemed best to begin with the testimony of the bankers and financiers. In this connection the plan for the hearings had recognized very clearly the probable opposition of interest between the inner group of city bankers

⁵ Hearings before the sub-committee of the Banking and Currency Committee of the House of Representatives, 1913.

which had been foremost in urging the Aldrich bill upon Congress, and the country bankers who had lent their support to that enterprise only in a grudging and half-hearted way and whose real interest was opposed to it. It has already been noted that in order to have the facts in the situation completely presented, invitations had been extended to a number of country bankers as well as to the supposedly more representative members of the profession from the larger cities. In analyzing the hearings, therefore, a beginning may be made with the testimony of the bankers, although this was not wholly taken at the opening of the sessions.

In general it was apparent from the outset that the bankers had appeared for the purpose first of all of recommending the Aldrich bill. Nearly all of them began their testimony by some reference to that measure or by the assertion that a centralized banking system of the type recommended by the Monetary Commission would be the preferred means of reformation. When pressed for a statement what they would suggest in the event that such a centralized system should prove to be out of the question, many of the bankers fell back upon the usual catalogue of "sound money reforms." Chief among these were the familiar "elastic currency," provision for refunding the 2 per cent bonds, improvement of bank examinations, and in some cases centralization or combination of reserves. It was deemed wise to present to the witnesses in most cases a hypothetical question designed to draw forth a reply as to the views of the speaker with respect to a bankers' bank or reserve institution if localized in some particular section of the country. This question was raised in order to ascertain if possible whether the bankers would regard a local reserve institution with favor or not. In the majority of cases an unwilling and tentative approval was extended to the local reserve idea, the evident view being that in the absence of a central bank such an institution would be better than nothing. Not a few of the witnesses were put to severe straits in their

efforts to explain why a local reserve institution if provided with sufficient capital would not fulfil all of the necessities of the situation and would not perform all of the services of a central bank. They also found it hard to explain, when referring vaguely to European experience, why it would be difficult or impossible for the United States to maintain a group of central banks similar to those of Europe when its territory and wealth were of sufficient extent to enable it to sustain more than the single institution which had been urged.

Doubts as to Aldrich Bill

The broader impression left by the testimony of the witnesses, however—particularly of those who represented the banking community—was that while they were thus generally committed to the Aldrich or Monetary Commission bill and while they were not particularly well prepared to defend its provisions (although prepared to do their utmost in behalf of the measure as drafted) a substitute for it if carefully framed would be acceptable to the more intelligent of this group.

As Mr. George M. Reynolds, president of the Continental and Commercial Bank of Chicago, expressed it: "I have all my life believed that if I could not get a whole loaf I should take half a loaf. . . ."⁶ This, Mr. Reynolds furnished as his position after recalling to the Committee that he had been associated with the Monetary Commission in Europe and elsewhere. He pointed out that his experience in Europe had led him to favor "some centralized supervisory power," although he did not believe in a "central bank," meaning by the latter "an institution where the powers were centralized and where the whole public had a right to do business with it." This was evidently the position of many others and tended to upset the view that nothing but the Aldrich bill would serve the purpose of banking reform.

J. V. Farwell of Chicago, who came before the Committee

⁶ Hearings, p. 258.

as a merchant (and who had been invited particularly because of his relationship to the National Citizens' League, of which he was president), presented "simply as an individual" the essentials of sound banking legislation as being: (1) a discount market, (2) a co-operative control of a large proportion of the dead cash reserve of banks, (3) an elastic currency, (4) a provision for international banking, and (5) the bestowal of a non-profit-making or non-commercial character upon the proposed co-operative institutions or central banks.

Professor J. Laurence Laughlin adopted very much the same point of view. He spoke as the chairman of the National Citizens' League and took the position that inasmuch as the Committee had apparently decided upon a number of reserve institutions the problem was merely that of developing a satisfactory technique of management. As he expressed it, "the remedies . . . should center about two objectives, first the inelasticity of the currency and second the organization of credit." He thought that it was desirable to work along lines already mapped out by the clearing houses of the country and he remarked that:

If you were to have a number of regional banks . . . the accounts of the notes and the method of issue and their protection and their elasticity could be cared for quite independent from the matter of discounts and deposits.

The issue function he thought was "not primarily a banking function," but a matter to be attended to as a problem of currency. The new institutions (if organized in districts, as proposed by the Committee according to his understanding) should do business only with banks. As for the Aldrich plan, he thought that there were "no jokers in it such as had been suggested by many people." Nevertheless it was "unnecessarily complicated" and could be a good deal simplified, while he believed also that there should be "some centralized body that could be entirely trusted to do things in such a way that they would act for all parts of the country."

Much the same point of view was adopted by a number of others. Festus J. Wade considered the question of organizing 12 or 13 regional banks, but he thought that they raised the problem of petty jealousy in the banking business. The creation of a regional system was feasible, but he thought that the necessity of the case called for "one general financial system." He had no doubt that almost any plan designed to attain the main objects of banking reform would be a great improvement over existing conditions and he urged that about all that was necessary to bring about co-ordination was the establishment of a central head that "had control over the whole system at one time."

Refunding the Bonds

From the standpoint of technique, perhaps the most interesting features that were developed related to the method of taking from the national banks the United States bonds which they were then carrying, retiring the notes based thereon, and issuing others instead, and to the question of bankers' acceptances. On the latter point the testimony—notably that of Sir Edmund Walker—clearly showed the danger of the unrestricted issue of bankers' acceptances up to 100 per cent of capital, which had been proposed in the Aldrich plan. As for note issue the testimony emphasized the necessity of insuring elasticity and guaranteeing responsiveness to business demand.

Political Problems

Politically the hearings made it evident that the chief difficulty in securing the adoption of a satisfactory banking bill would be found in the special interests of various groups of banks with reference to certain essential features which they themselves in the abstract were ready to admit called for correction. The hearings in fact made it plain that the banking question was essentially not a political issue but a business problem and that the time had come to deal with it coura-

geously and from a non-partisan standpoint without fear or favor, the legislators to be guided only by the obvious necessities of commerce and industry. Upon the Committee itself the testimony had an excellent influence, tending to develop a far greater degree of solidarity than had previously existed, besides clearing up any doubts which had existed in various minds with reference to phases of the proposed legislation that were not altogether obvious to them. Only in one particular was the series of hearings a disappointment. It aroused little or no interest and produced little or no effect upon the public mind, the general rank and file of the bankers of the country apparently regarding it with only very mild interest. The proceedings were hardly reported at all in the press, due to lack of demand for current news reports about them. Out of this state of things grew up the subsequent superstition that there had never been any thorough hearings on the proposed legislation but that everything had been conducted on behalf of the House of Representatives, "behind closed doors."⁷

From one standpoint, this situation was exceedingly satisfactory—there had been no opportunity for the development of further prejudice or for misrepresentation of what was on foot. The hearings had been held, all parties at interest had been given an opportunity to express themselves, and the ground had thus been cleared for some real work when the time came. The hearings themselves closed only a few days before the termination of the congressional session. Many apparently believed that because nothing had been reported and no public action taken, the whole enterprise had been a flash in the pan. This, however, was not the case.

⁷ From what has been said it will be clear that the mere assembling of a suitable list of witnesses for the proposed hearings was a very considerable task and that, far from knocking at the doors of the Committee, as was afterward reported, those supposedly interested in the legislation could scarcely be induced to present themselves. The question has often been raised why such a situation should have existed. Some have explained it on the ground that the whole enterprise was regarded as a mere piece of political byplay, no one believing that any serious results would be attained. By others the view has been expressed that there was "distrust" of those who were in charge of the work and a belief that they would speedily be displaced when the time came (if ever) for a practical effort at legislation.

Bills Filed with Committee from Outside

In concluding the chapter attention may be drawn to the fact that just before this stage of the history of the bill efforts began to be made from many quarters to shape the work of the Committee. Partly due to the unsolicited and officious offers of co-operation and the great amount of material that was being voluntarily filed with the Committee, its members, or its expert, decision had been reached to solicit an expression of opinion generally from all who cared to present their ideas. This, too, was deemed especially desirable and fair because of the relative smallness of the number of those who could be invited to appear before the Committee or who, if willing to appear, could be heard. It was therefore generally and authoritatively made known through the press that the Committee was receptive in its attitude and would gladly receive all possible suggestions. To those who had offered to draft measures for it the response was made that their plans would be welcome, and when inquiry was made as to what the Committee had in mind such inquirers were given a broad general notion of the lines along which such work must proceed.

In this way there was produced a considerable group of bills, many of which since then have been announced by their respective authors as the original measure. Some of these were quite frankly revisions of the Aldrich measure. Others were based upon the Aldrich motions but made little use of the actual language of the Monetary Commission bill. Still others were framed on a "regional" basis, it having become noised abroad that the President had assented to or had accepted such a plan, but were otherwise entirely conventional. Fairly representative of these were some that made their appearance in Congress. Still others incorporated so much of the Committee's views as had become known and added new features devised by their authors. Among the bills thus placed in the hands of the Committee were the Garrison and

Scott proposals, the Hitchcock plan, the various Fowler bills, a measure outlined by J. Laurence Laughlin of the National Citizens' League, the Aldrich bill itself in different forms, and many others. In order, however, to be certain of getting as wide a range of suggestions as possible, the Committee sent to a large list of economists, financial authorities, and others a set of questions on banking and at the same time requested any bills that might have been proposed by the recipients or any bills that they regarded with special favor. Among those who were thus addressed were the best known writers and authorities on banking in the United States and the bills and suggestions thus received were considerable in number, although, owing to the long continuance of the banking discussion, most of them had already become public in one form or another.

In some cases those who thus for one reason or another filed bills with the Committee undertook to "keep them up to date," filing successive drafts as further changes occurred to their authors, so that there was at no time any standard draft bearing such an author's name. In one or more cases such a bill was "kept up to date" by incorporating into it portions or paraphrases of the Committee's bill as the latter became public. The final product, since—in one case at least—issued as the "original bill," however, contains, verbatim, changes in language not previously known, which were written into the measure at a White House conference of politicians some six months later and which evidently could not have been incorporated six months before.

All these measures, drafts, and suggestions were carefully read and digested for such light as they might throw on the lines to be followed. This study and analysis confirmed the determination to adhere to the original plan already drafted with no material modification. The present author, when later examined by the Senate Committee on Banking and Currency (Hearings 1913, Vol. III, pp. 3013-3088) used the fol-

lowing words concerning the preparation of the Federal Reserve bill in the House Committee:

I do know that it is not a fact that one [outside individual or organization] more than another was instrumental in outlining or framing this bill, so far as I have any knowledge or belief.

CHAPTER X

CONSULTING THE FINANCIAL INTERESTS

Secretary McAdoo

In former chapters it has been seen how the bill which later became the Federal Reserve Act, was presented to President-elect Wilson, then at Princeton, on the day following Christmas, 1912, and subsequently at Trenton, just before Mr. Wilson left that city for Washington, there to be inaugurated as President. It has been made clear that only on these two occasions had the President examined the bill, first orally and in general outline, and later in the form of a tentatively completed draft. President Wilson had not allowed it to become known who would be his Secretary of the Treasury, or, indeed, any of the members of his Cabinet. Consequently the public at large was not advised of the nomination until the 4th of March, 1913. Although rumors had reported the possibility of the nomination of Mr. W. G. McAdoo as Secretary of the Treasury, such rumors had not had any definite foundation so far as could be ascertained. It had therefore been impossible for the House Banking and Currency Committee or its chairman to communicate with the prospective chief of the Treasury Department. Chairman Glass, moreover, had had no acquaintance, or only a very casual one, with Mr. McAdoo, so that when his nomination was announced there was a natural pause in the process of advancing the new currency law. This temporary delay was broken by a telephone message from Mr. McAdoo to Mr. Glass about the middle of March. The substance of the message was to the effect that the new Secretary of the Treasury was very desirous of considering with Mr. Glass

the terms and details of the bill which he understood the latter had had in preparation. In the conversation Mr. McAdoo referred to various reports which had been in circulation in the newspapers, which were to the effect that he was close to, or interested in, Wall Street concerns, indicating in positive language the baselessness of any such accusations and asserting his entire freedom from any alliance in non-governmental interests. The outcome of this conversation was a personal interview between the new Secretary of the Treasury and Mr. Glass, and this was followed by a number of others, in the course of which a general outline of the new bill was orally furnished to the Secretary of the Treasury.

Colonel E. M. House

Progress, however, was very slow and there was an apparent feeling on the part of members of the administration that Mr. Glass had not sufficiently provided them with information. Accordingly, Colonel E. M. House, the adviser of the President, who even at this early date was apparently vested with very large powers of a vague sort, was led to interest himself in the situation. He showed a considerable disposition to discuss the currency question. These conversations eventually led to a dinner appointment at the house of Hugh M. Wallace. After the dinner the banking situation was discussed, a copy of the new bill was read over and discussed by Secretary McAdoo, Colonel House, and Mr. Glass, and in closing the evening session Colonel House made a request for a copy of the bill. Mr. Glass declined to transfer his copy of the bill, it being the only one in his possession, but a few days later he received a request from the President for a digest stating the essential features of the measure. Mr. Glass acceding, such a digest was prepared by the author and was furnished by Mr. Glass to the President.

Because of the fact that the statement made up and furnished to the President describes in brief, intelligible form the

precise stage which had been reached by the bill at the outset of the Wilson administration, and because it formed the basis upon which the measure was first laid before the financial interests, it is thought best to present it in full as follows:

MEMORANDUM ON SCOPE AND EFFECT OF H. R. — TO REORGANIZE
THE PRESENT BANKING AND CURRENCY SYSTEM

In H. R. —, prepared for introduction by Representative Glass of Virginia, it is intended to furnish a comprehensive measure for the attainment of four objects:

(1) Provision of a place for rediscounting commercial paper of specified types.

(2) Provision of a basis for elastic note issues properly safeguarded.

(3) Refunding of outstanding two per cent bonds so as not to inflict loss upon present holders.

(4) Provision of machinery for doing foreign banking business.

In order to accomplish these purposes fully it is necessary to (a) repeal certain portions of existing law; (b) rectify various conditions in the present national banking system which are in some cases only indirectly connected with the objects sought; (c) furnish a new class of institutions for the performance of some functions which cannot well be entrusted to existing banks, or at all events can better be performed by others and (d) alter the present reserve system to a very material degree.

The scope of the bill can best be understood by an analytical review of its contents, with references to sections and paragraphs. This is herewith subjoined.

BASIS OF PRESENT SITUATION

The present banking situation in the United States rests upon the National Bank Act proper as slightly modified from time to time and upon the so-called Aldrich-Vreeland Act (act of May 30, 1908). Of these acts the latter is completely repealed (section 1) on the ground that it has never become operative, probably will not become operative except under extreme stress, and was never satisfactory. The National Bank Act itself is modified in numerous essential particulars which will be pointed out from time to time in this memorandum. In a separate measure a general revision of the administrative provisions of the National Bank Act is also provided.

NEW CLASS OF BANKS

Fundamental to the idea of the bill is the creation of a new class of banks (section 2), to be known as National Reserve Banks. The chief points about these banks are as follows:

(1) Number to be 20 with possible increase later as provided. (Section 2.)

(2) Ownership to be in the hands of the National Banks of the 20 districts in which the banks are situated. (Section 2.)

(3) Capitalization to be 20 per cent of the capital of the stockholding banks, one-half paid in and one-half subject to call. (Section 2.)

(4) Business to be as follows:

(a) Rediscounting of paper presented by stockholding banks and by other banks under specified conditions, provided such paper grows out of actual agricultural, commercial or industrial transactions and does not run more than a specified number of days. (Section 14.)

(b) Buying and selling Government securities, gold and silver bullion and foreign coin, foreign exchange. (Sections 16 and 17.)

(c) Government fiscal operations. (Section 21.)

ISSUE OF NOTES

The bill provides for the maintenance of existing bank notes outstanding so long as their present issuers want to keep them out, and also calls for the establishment of a note issue on a new basis to be put out by the National Reserve Banks. Provision is, however, made for retiring the present National Bank notes at the discretion of their issuers. This plan comprises the following points:

(1) Every National Bank would be allowed to continue its note issue exactly as at present. (Section 26.)

(2) It would not, however, be allowed to increase the issue beyond the point at which it stood when the law was passed. (Section 26.)

(3) No newly organized bank would be required to purchase Government bonds, hence no new bank would have any note issues. (Section 26.)

(4) Whenever an existing bank retired any of its notes and withdrew its bonds it would lose the right to put out further issues of notes above the amount to which its issue was thus reduced. (Section 26.)

(5) National Reserve Banks would be allowed to issue notes secured in the same way as their other obligations to an amount equal to twice the par value of their capital stock. They would also be

allowed to issue additional notes if they desired, equal to the amount of notes withdrawn by the individual banks which might from time to time surrender their note issue privilege in part or in whole. (Sections 23 and 26.)

DISPOSAL OF U. S. BONDS

Recognizing (a) that the present 2 per cent bonds were sold to the banks on the basis of a pledge that they might continue to be used as a basis for circulation, and that therefore the Government is morally bound to maintain their value in a corresponding degree; (b) and that it is desirable to retire the bonds now held behind bank notes and put in their place bonds whose value is sustained solely by their income-paying power, it is provided that

(1) Banks now holding the bonds may offer these bonds for redemption or conversion into 3 per cent bonds at a rate not to exceed one-tenth of their holdings each year. (Section 26.) This would mean that a maximum of about \$65,000,000 a year could theoretically be converted, and the evidence is that that sum would be absorbed without difficulty by investors each year.

(2) At the end of ten years other holders of bonds would be allowed to convert them into 3s. (Section 26.)

(3) As a result of these changes the Government would be obliged to increase its interest charge the first year of the new arrangement by an amount not greater than one per cent on \$65,000,000, or \$650,000, while the second year a like addition would be made and so on, until at the end of ten years a possible maximum addition of \$7,300,000 in interest charges would probably have been assumed.

PROTECTION OF NOTES

Fully admitting the necessity of an absolute protection of note issues, the bill seeks to safeguard those for which it provides as follows:

(1) National Bank notes are safeguarded at every point by exactly the same elements of protection which exist today, none of these being diminished in the slightest degree.

(2) Notes issued by National Reserve Banks are protected by a large gold reserve, by constant close Government supervision, and by immediate and prompt redemption. Stringent provisions are made against counting any of these notes as a part of bank reserves, thus insuring their speedy return to the point of origin. (Sections 30, 31, etc.)

(3) All notes are made receivable by the Government and are to be received by every bank in the system on deposit at par, without exchange. (Section 23.)

(4) Uniformity in the currency is obtained by making the National Reserve notes identical in appearance and wording with the National bank notes. (Section 23.)

(5) Power to oversee and control the issue of notes is placed in the hands of a supervisory board. (Sections 13, etc.)

GOVERNMENT CONTROL

Overseeing the whole system is created a so-called Federal Reserve Board (Section 13) with the following organization and functions:

(1) Board to consist of representatives of (a) national reserve banks (b) bank stockholders (c) the government itself. (Section 10.)

(2) Actual working body to be an executive committee of this Board consisting of Secretary of the Treasury, Comptroller of the Currency, and Attorney-General, with four members of the Federal Reserve Board chosen by the latter. (Section 11.)

(3) Board and executive committee as thus made up to have power to deposit Government funds in National Reserve banks, to fix rates of rediscount in such banks, to compel any National Reserve Bank to rediscount the paper of any other, and to examine the banks of the system. (Section 13.)

STRUCTURE OF SYSTEM

The effort has been made to "popularize" the control of the whole system of banking thus built up while at the same time preserving a sufficient amount of centralization, controlled by Governmental agency, to insure that the whole system shall be responsive to legitimate public demands. The bill is based on the belief that no one should participate in the control of the system unless he is either financially interested himself or chosen by those who are, save insofar as the Government steps in to exert the authority of the whole community. With this in mind the system has been developed as follows:

(1) Organization, powers and functions of National Banks are left as at present.

(2) National reserve banks are incorporated institutions holding federal charters and in all respects managed like national banks except as to the election of directors which is provided for as follows:

(a) Banks in every district are divided into five classes according

to capitalization. In each class the directors of the banks nominate a candidate for the directorship of the Reserve Bank. These are then voted on (one bank one vote) and a director is chosen for each of the five classes—five in all. (Section 4.)

(b) In the five classes aforesaid bank stockholders vote for and elect a director for each class by a process prescribed in each case making five in all, or with the preceding five, ten. (Section 4.)

(c) The ten men thus named select four others after a prescribed process, eight votes required to elect, and the nominees subject to rejection by the Federal Reserve Board. (Section 4.)

(d) A fifteenth member, to be chairman of the Board of Directors is chosen by the Federal Reserve Board itself. (Section 4.)

(3) The Federal Reserve Board consists of two members from each district and the three Government officials already specified. (Section 10.) It is not an incorporated body, has no banking functions but is supervisory.

(a) One member of the Federal Reserve Board in each district is chosen directly by the directors of the National Reserve Bank of the district. (Section 10.)

(b) A second member of the Board from each district is chosen by the bank stockholders of the district, voting by a prescribed method. (Section 10.)

(c) These members of the two classes referred to choose by ballot four of their own number to join with the Government officers already mentioned as the executive committee of the board. These four are designated by the Secretary of the Treasury to hold the offices of President, first and second vice-presidents and secretary of the Federal Reserve Board. (Section 11.)

RESERVES

In the belief that the present reserve system is antiquated and unsatisfactory, that the massing of funds in New York and other financial centers of which so much has been said in recent years, is largely due to the present reserve requirements of National banks, and that in order to get the real benefit from the system of rediscount which has been proposed as a remedy for many existing evils, it is necessary to base such system upon an actual control of reserves, provision has been made for recasting the present bank reserve system. The plan includes:

1. Transfer of reserves from existing National banks in Reserve and Central Reserve cities, to National Reserve Banks. (Section 27.)

2. Spreading out of this process of transfer over a period of fourteen months in order to give as little shock as possible to market conditions. (Section 27.)

3. Ultimately the establishment of a reserve system, at the end of the transition period in which so-called country banks will have 15% of reserve (i.e., 15% of total demand liabilities) such 15% to be held 5 in the bank's vaults, 5 with the National Reserve Bank and 5 either at home or with the reserve bank; while reserve and central reserve city banks will have reserves of 20% of demand liabilities of which 5 will be at home, 5 with the Reserve Bank of the district and 10 either at home or with the reserve bank. (Section 27.)

4. The presumed effect of this plan will be to end the placing of reserves with Central Reserve city banks for use in stock market operations, to keep reserves in some measure at home, and to require speculators to get the funds they need in their operations either by directly borrowing them from persons who hold them and want to lend the cash for that purpose or else by borrowing from the banks in the places where the operations are to be carried on.

DIVISION OF BUSINESS

The object of the bill is to effect a moderate division and classification of banking business along indicated lines, the net result, presumably, being summed up as follows:

1. National Reserve banks will be strictly limited to actual commercial and industrial transactions evidenced by very short term paper and on rare occasions under carefully prescribed conditions to financial operations protected by collateral. They will also be able to engage in foreign exchange operations, sales of Government securities, etc., as already explained.

2. National banks will be subjected to precisely the same restrictions as at present with a relaxation in favor of a moderate amount of real estate loans by country banks under carefully guarded conditions. (Section 39.)

3. By a revision of the administrative features of the National Banking Act, provision will be made for close oversight of National institutions with a view to holding them strictly up to the requirements of a legitimate banking business. (Text of bill still to be submitted.)

4. In order to possess themselves of the kind of paper entitling them to rediscounts, National banks will find themselves obliged to keep a reasonable proportion of their assets in the form of paper

eligible for rediscounting, and this will mean very considerable emphasis upon the strictly commercial aspects of the business done by National institutions.

POSITION OF STATE BANKS

It has not been thought wise to permit State banks to own stock in the national reserve banks for two reasons:

1. State banks by the terms of their organization are differently managed and controlled from National.
2. The laws of the States differ with respect to liabilities, the collection of debts, and other matters.

Hence the bill has attempted only to provide for giving these banks equal facilities for doing business by establishing the following conditions:

1. State banks may affiliate themselves with National Reserve banks by maintaining the same deposits with the National Reserve banks that are kept by National banks under the proposed act. (Section 29.)
2. State banks shall in these circumstances be entitled to do business with and get rediscounts from National Reserve banks. (Section 29.)
3. State banks shall be subject to inspection and examination by National Reserve banks. (Section 29.)

RELATIONS WITH TREASURY

It is believed that the present Sub-Treasury system is unsatisfactory, clumsy, injurious to business and difficult to manage in times of stress. The bill therefore provides for:

1. The placing of all current funds of the Treasury in National Reserve banks and the payment of Government creditors by check thereon. (Section 21.)
2. The equalization of the public funds between the different reserve banks subject to a rate of interest to be fixed by the Federal Reserve Board. (Section 13.)
3. The trust funds of the Treasury are to be held as at present in the vaults of the Treasury.

FOREIGN BANKS

Recognizing that present banking legislation under the National system is inadequate in its relation to foreign trade, because it furnishes far too little recognition of the necessities of the case, and

believing that the development of foreign banking ought to be aided and promoted and at the same time regulated by the National Government, it has been sought in drafting the bill to provide:

1. A new type of institutions created for foreign trade purposes and organized by individuals or existing National banks or both. (Section 41.)

2. Permission to establish branches in foreign countries and whenever necessary under specified conditions to establish such additional branches in the United States as may seem requisite.

3. Authority on the part of the National Reserve banks to deal in foreign exchange and otherwise to facilitate operations involving international trade. (Sections 18 and 19.)

4. Permission to National banks to do an acceptance business in all matters relating to foreign trade, the importation and exportation of goods, the furnishing of travellers' funds on letter of credit, etc.

5. The more efficient and successful handling of financial relations between the United States and foreign countries through the placing of Treasury funds in the hands of National Reserve banks.

McAdoo's Communication

The next step in the discussion of the bill was afforded by the letter from the Secretary of the Treasury reproduced on pages 178 and 179.

Reply of Financial Interests

This reply to, or comment on, the memorandum description of the bill (being the first definite response on the part of those who had been foremost in support of the Aldrich measure) is presented in detail as follows:¹

NUMBER OF BANKS FUNDAMENTAL

With reference to Mr. ——'s plan, a synopsis of which you permitted me to see yesterday, I herewith give you a short resumé of my criticisms.

Whether a plan of National Reserve Banks as outlined in this draft

¹ This memorandum was supplied to the author unsigned. He later learned from Mr. McAdoo that Colonel House had delivered the outline sketch originally given to the President, to Mr. Paul M. Warburg, of New York, who in reply wrote the memorandum herewith presented in the following pages.

next Friday would expect
to be in New York &
you have; at that time,
a complete copy of the
bill, I understood to
go with it with
you in express.
I suggested that the
ideas we discussed
be formulated in dep-

Apr. 27.
Mr. L. L. Collins?
Our friend Cal. Knicker
has sent me the enclosed
observations on the
proposed bill. I send it
to you in confidence -
since if it seems to me
to have force. I wish
you would read it care-
fully & be prepared to
discuss it with me

glad of this. That this
 inclusion is com-
 pletely as it
 comes to me that
 may be nicely for
 reference

mate sheets may be
 suggestions for dis-
 cussion before your
 attempt to accept the
 entire bill as you
 have it now. The
 suggestions I offered
 are tentative and do
 not represent my
 final conclusions.
 I shall advise Mr.

is sound or unsound will depend entirely upon the number of such banks. You can readily see that if you had fifty independent reserve centers, the plan, for many obvious reasons, into which I need not go in detail, would be an impossible one. If you had three, four, or five, I could see that you could develop a desirable plan. I mention the large number of fifty, in order to show that this is not a question of theory, but of practical application. I believe that what Mr. Willis stated in yesterday's Journal of Commerce is substantially correct, that most of the men who have been asked how many regional reserve banks will be required, have answered, off hand, about fifteen or twenty. However, I doubt whether any of these men have given the question very careful consideration. What I believe, was in the minds of these men, was that there must be at least fifteen or twenty points at which the banker might be able to deal with a central organ. I quite agree in that; I even believe that fifteen or twenty will not be a large enough number in the long run. I have always held that the Aldrich Plan did not provide for a sufficient number of branches. The country is too large and increasing rapidly, and the law must provide a sufficient flexibility, that is, a sufficient amount of faucets which can be turned on in each part of the country, so that all important cities can be easily taken care of. While, however, we need a large number of faucets (I think it will not take long before you will need at least thirty), you need a small number of central reservoirs.

A FINANCIAL "RESERVOIR"

To come back to my old illustration: if you establish too large a number of central reservoirs, and provide, as the law does, that there should be a supervisory organ at Washington that will interconnect these reservoirs, and may issue an order that New York shall provide for New Orleans, or Chicago shall provide for San Francisco, or Milwaukee for Texas, you will establish a very cumbersome machinery, and there will be various difficulties in handling the same. There will always be the feeling that you take away something from one locality and give it to another locality, against which there will always be some resistance and resentment, and justly so. Moreover, it will be a terribly round about and queer way; just consider what will happen if at first Milwaukee should be ordered to help Texas, and then Chicago be ordered to help Milwaukee and ultimately, possibly New York to help Chicago. It will be very difficult to ultimately read the gauge of how the water really stands in each center, because there will be so much roundabout interference. Moreover, it will be impossible to

break down the local character of the administration of each center. It will be swayed entirely by local considerations, because the unit is too small; a large, patriotic and impartial view will not develop; it will always be one part of the country looking out for its own interest against that of the other; instead of having a unit, all working for the same purpose, you will have each corner working for itself. This will not only be a poor organization unable to bring good results, but, in addition, it will be dangerous, because if in a particular locality, a strong demand for accommodation should exist, it will be very difficult for those very same men to sit in judgment upon themselves and to decide that such accommodation should not be granted, or possibly be granted only in a hesitating way (in order to interfere with too rapid an expansion). This National Reserve Bank must very often take the opposite view from those that are in the banking business in order to make money and that feel that they have to comply with the demands of their customers.

BANKING IN PROSPEROUS TIMES

When business expands and all is going well, it is the function of a National Reserve Bank to accumulate funds and provide for adverse times, and vice versa, in adverse times, when the banks have reached the end of their tether and would be afraid to provide, even for legitimate needs of the country, the National Reserve Bank is willing to expand. In order to bring this about you have to break down the local or provincial character of each board, and you have to construct large units, which, not representing individual localities, will be able to develop more of a national view in all the functions which a National Reserve Bank should primarily exercise. That is to say, the concentration of reserves, the creation of a discount market, the handling of the Government bonds, an elastic note issue and the accumulation of foreign exchange (to be kept as a reserve in case of need, and incidentally having for its object the withdrawing of the funds of the National Reserve Bank from active employment in the United States in times of dangerous plethora) can best be exercised if one single reservoir would be created. If that cannot be done, for reasons which I can well understand, a few numbers of large reservoirs should be created; three or four (if it absolutely must be, five, though that, to my mind, would be too many) because then you could get boards for these four units which would be national in character, and they would be in a position to stand by each other, and be mutually responsible for each other and assume joint responsibilities—like the note issue—without

feeling that one locality is depriving itself of its own means of sustenance in order to help the other, and that in doing so it may possibly run a risk.

DEVELOPING A NATIONAL POLICY

A definite and national policy can be developed by so small a number of units, and it can be carried out (concerning the purchase and sale of foreign exchange, discount rates, purchase and sale of Government bonds), a proceeding which is practically impossible with a larger number. If this point of view be adopted, which I do not think is contrary to the principle of the law as drawn at present, I think a very creditable measure may be developed. It may even have some advantages over the Aldrich Plan, because it is possible that these three or four units, if need be, may have different rates of discount, while in the Aldrich Plan the one rate for the whole country may prove embarrassing at times. Moreover, with the Aldrich Plan the fear remained to my mind without justification, but that does not matter—it existed, that Wall Street, somehow or other, might secure control of the whole machinery. If three or four units would be created, New York's influence would be restricted to the East, and the South, Northwest and West would be entirely independent within their own domain. To delegate to the Federal Reserve Board the power of fixing the rates for each of the twenty (or twelve) National Reserve Banks and to decide upon the question whether they should have additional funds, and which of the others is to provide them, is too large an order. It would be very dangerous for the Secretary of the Treasury or the Attorney General to be involved in questions which are too local in character upon which they cannot possibly have any judgment of their own, and which, moreover, might *easily lead to insinuations and to suspicions of favoritism or unfairness, whichever way they might decide!* *It is much safer for these gentlemen in Washington to deal with the largest possible units which would protect them in that respect.*

LARGE NUMBER OF BONDS FATAL

To sum it up: A large number of coordinated units I would consider fatal. The number would either not be large enough to be adequate for the country's needs, or it would be too large, in order to be a safe and practical proposition. What is needed is clearly this: A large number of National Reserve Banks, let us say a provision for up to thirty, beginning with a fewer number, for the time being, each

equal to the other in rights and privileges, but these National Reserve Banks are to be put under three or four centers. Let us say, for argument's sake, three centers, each being composed of up to ten National Reserve Banks, would form one distinct group in themselves. It would be easy to devise some good scheme to have the center of each group administered by members delegated by each National Reserve Bank, and the Federal Government would add the head, and as many more members as Congress might think necessary and advisable. These three (or four) center boards would then delegate members to the Federal Board of which the Governors of each center, three (or four) in number, should be members. You would then have three really important men of national standing, who would have been the choice of those three (or four) entire sections of the country, to constitute a strong nucleus of the Federal Board, and if you added to those a President of the Federal Board, who would be the head of the whole structure, you would have a cabinet there which would be something to be secure and proud of. To those you would add, as proposed in the Bill, some members of the Cabinet of the President of the United States. You would then have only a few interchangeable reservoirs, but with a great many faucets everywhere, and a system that can be handled. Every efficient organization must have heads of departments, and men responsible for each branch as you go down. As the law is drawn now, I see twelve or twenty armies with twelve or twenty generals, but I do not see any captains or any regiments, the regiments, as a matter of fact, have become armies, and you can see where that would lead to. This plan of mine would provide for three (or four) generals, with a general staff in Washington, and each general to be responsible for his seven to ten captains, which constitute his unit.

I regret that I had to be so longwinded concerning this Point 1, before coming to the other points in detail, but this is a fundamental principle which we have to establish first, and unless I may consider this as granted and adopted, I would have to go into this question again and again at each point.

OWNERSHIP TO BE IN THE HANDS OF THE NATIONAL BANKS

I think this would be a mistake. There are several states in which State Banks, and Trust Companies, for instance in Illinois, are of greater importance than the National Banks. The basis of the National Reserve Banks ought to be as broad and as strong as possible, and I strongly believe that National Banks, State Banks, and Trust

Companies should be admitted to the privileges of the new organization on equal terms, provided they submit to certain rulings as to their reserves and to supervision, and on equal terms as to the holding of stock of the National Reserve banks. The holding of such stock is not a bonus but an onus. It means locking up of funds by these banks of 10 or 20% of their capital, and to permit the State Banks and Trust Companies to come in as far as the privileges of dealing with the National Reserve Banks are concerned and not to force them to contribute as stockholders would not be fair to the National Banks. On the other hand, to keep the State Banks and Trust Companies out completely would create such an antagonism on the part of these latter institutions that the legislation probably could not be gotten through, no more do I think it should go through, because it would not be a fair legislation. Senator Aldrich started on the same basis of dealing only with National Banks, and was ultimately forced to change his viewpoint as to the State Banks and Trust Companies.

I have no criticism concerning Points Three and Four. Of course it would be very important to know the details of Four A and B, as to what these "specified conditions" will contain.

NOTE ISSUE

I think any limit (as in this case twice the par value of the capital stock) is inadvisable and dangerous, because whenever the limit is being approached helplessness stares the country in the face, and a panic may ensue. I favor a limitation of the Note Issue by a prescribed gold reserve which is to be maintained. It is then always within the power of the administration of the National Reserve Banks to take steps, no matter how drastic, to increase the gold holding, and thereby to meet the situation, but you are not up against a fixed limit. If you deal only with three or four large units it would be easy to pool the status of the three or four units, and stipulate that the total note issue should always be covered by at least $33\frac{1}{3}\%$ in legal tender notes or gold.

(I shall have to treat together the note issue and the disposal of the United States Bonds.)

I think the plan as provided in the draft of the law is a weak one for several reasons. The argument begins by stating that it is proposed to convert the 2% Bonds into 3% Bonds in order to protect the National Banks from making a loss on the 2%s. This is equitable; but if you consider the German Consols within ten years went down from par to 75% and that English Consols and French Rentes moved

down in a similar way, you may readily see that there is no guaranty at all that the Banks will not incur heavy losses, when finally they can dispose of their last 10% of bonds. This, however, is not the main consideration, but you have to consider what the status of the United national reserve banks would be when all the Government Bonds would be in the hands of the public after ten years. We have to presuppose that the amount of currency now used by the country will substantially remain the same. The country has adjusted itself to this amount, and while, on the one hand, possibly, when the National Banks will have less interest in keeping out their Notes, the circulation may decrease to a certain extent (which we can only guess at, and which probably will not be very large), the population, on the other hand, will increase, and so will the deposits in the banks, and therefore a larger amount of currency will be required as the years go on rather than a smaller one. Against each note in circulation there must be some asset, because each note is issued only against some consideration. If the Government Bonds do not figure any more in the status of the United National Banks as an asset against the liability of their note issue, and if the National Reserve Banks when they assume the old note issue, or substitute the new notes for the old ones which the National Banks withdraw yearly, and if the National Reserve Banks do not acquire the Government Bonds, it means that the United National Reserve Banks, in order to keep out the \$750,000,000 of Notes, now represented by the National Bank Notes, will have to invest \$750,000,000 in commercial paper or foreign exchange! This means that at all times, even in times of plethora, the National Reserve Banks will have to have an actual investment of this enormous amount, and in times of active money when the function of relieving the market should only begin, they would have to step in with additional hundreds of millions of dollars. This is just what should be avoided. The United National Reserve Banks should not be forced at all times to be as active in business as that. It would tend toward inflation, which should be avoided.

OFFER TO BUY BONDS

My suggestion would be that an offer be made to the National Banks to purchase from them at once their 2% Bonds and to assume a corresponding amount of their note issue by the United National Reserve Banks. The National Reserve Banks would convert half of the amount of the bonds so purchased into 3% Government Bonds of which they might be permitted to sell 10% per annum, but they should

not be obliged to do so. The other half of the amount of Government Bonds received would be converted into *one-year 3%* Treasury Notes of the United States and the United National Reserve Banks would undertake to renew these Treasury Notes of the United States every year at the rate of 3% whenever they fall due; such undertaking to be in force as long as the charter of the National Reserve Banks will last. From the banker's point of view the result of such a measure cannot be too strongly emphasized. It means that while the United National Reserve Banks will not be forced all the time to invest in commercial paper, because their money would be invested to so large an extent in Government securities, the National Reserve Banks would not be in the precarious situation in which they would be placed by the Aldrich Plan under which they were forced to hold \$750,000,000, which they practically could not sell in case of need. The National Reserve Banks would, at all times, be in a position to dispose of these \$350,000,000 of United States One-Year Treasury Notes, either at home or abroad, because for a short Government Note of the United States there will be always money available at a price, it will be only the question of the rate of interest at which the National Reserve Banks would be willing to offer. It would not be difficult, therefore, to liquidate \$350,000,000 in such a way as might enable the National Reserve Banks to draw gold from Europe when it should be required, or, when it would be necessary, substantial credits could be created in Europe in order to obviate gold exports from the United States. This power to influence the flow of gold is a most important feature, which, in the present law, is completely neglected.

I can see everything in favor of such an arrangement, and nothing against it, but I do not want to tire you by lengthening the argument. I furthermore think that it is extremely desirable to deal with this question of note issue and government bonds in a comprehensive way, and not to continue *two kinds* of note issues. (Moreover, if you left the privilege, as suggested in the law, that anybody might convert, after ten years, the 2% Bonds into 3% Bonds, some of the Banks which do not apprehend a fall in the 3%*s*, as outlined before, might indefinitely continue their note issue, which is profitable for them, and take their chances on the ultimate sale of their bonds.) In order to have an efficient hold on the market, it is extremely desirable that there should be a definite policy as to the note issue, and that the note issue at once should become as elastic as possible. If you left the National Bank note issue outstanding to a large proportion, as in the law provided, an effective control by the National Reserve

Banks will be postponed, and I strongly recommend to your careful consideration the modus suggested by me, which by the insertion of the United States Treasury Notes brings about safety, control, and elasticity from the beginning.

PROTECTION OF NOTES

I do not believe that it is sound not to count Notes as reserve when a balance with the National Reserve Banks is to be counted as reserve. Notes and balances are interchangeable, and if the one is to be counted as reserve, the other should also be, but I prefer not now to enter into this discussion, which, from past experience, I know to be a very difficult one, and to deal first with the main questions.

I have nothing to say concerning the paragraph of Government control, and agree in principle. As to how feasible or how practical the modus of election is, I have no judgment until I can see how these phases have been worked out in detail.

RESERVES

I am somewhat at a loss to discuss the paragraphs dealing with reserves, inasmuch as No. 3 under this heading contains a synopsis which I cannot understand. Dealing with country banks, it is said that "of their 15% they may hold 5% in the bank's vaults, 5% with the National Reserve Banks and 5% *either at home or with the Reserve Bank* (does this mean National Reserve Bank or banks in reserve or central reserve cities?) while Reserve and Central Reserve City Banks will have reserves of 20% of demand liabilities, of which 5% will be at home, 5% with the *Reserve Bank* of the district (I suppose this means National Reserve Bank) and 10% *either at home or with the Reserve Bank.*" (I fail to understand what this Reserve Bank means.) With the object that the framers of this law had in mind, that is, the development of a discount market and the withdrawal from the stock exchange of the very large amount of reserve money employed there now, I heartily agree. However, two points must be borne in mind. We do not develop a discount market simply by having twenty places at which banks may rediscount with the National Reserve Banks. By that we would construct one means of rediscounting, and a pretty restricted one at that. The discount system in Europe provides for a general open market and of the large amount rediscounted every day, only a small fraction, and, as a rule, only the short maturities go into the so-called Central Banks. There is, as a rule, one center which is more important than the others, and this,

as far as the foreign countries are concerned, establishes the main standard of credit. This is London, Paris, or Berlin, while some additional markets naturally develop in the main centers of commerce and trade, such as Lyons, Marseilles, and other cities in France, or Hamburg, Frankfort, Bremen, and many other cities in Germany, and the Scotch cities and the big manufacturing and shipping places in England. There must be certain main centers where money accumulates and where discounts are being purchased and sold freely by the Banks, Discount Companies, and private firms, which deal in these bills because they have that free market, while, underlying it all, is the expectation that in case of need the central institution will be there to purchase the bills. But this central institution is applied to only to a comparatively moderate degree in normal times. It looks to me as if it were extremely important that such places as Chicago, St. Louis, Philadelphia, Boston, New York, New Orleans, and San Francisco should develop into discount centers, of which Chicago, St. Louis, and New York would probably become leaders.

UNDESIRABLE TO SHIFT RESERVES

In order to bring this about, I think it would be undesirable, anyhow at this juncture, to interfere too radically with the function of reserve and central reserve cities. I believe that the accumulation of funds in these cities will be a healthy one for the development of these discount markets, while, on the other hand, a disturbance of the functions as they exist at the present time might create considerable havoc. Do not forget that financial conditions in this country at present are extremely precarious ones. Fourteen months is a very short time to adjust conditions, and I have grave apprehensions that interference, as planned by the present law, if I understand it, about which I am not sure, might cause most serious disturbances. The mere fact that Reserve City Banks and Central Reserve Banks will have within their reach in the future a means of investing their own demand deposits in bills of exchange which they can resell, will quite of itself cure the present evil of dumping all this on call money on the Stock Exchange in New York. In other words, a Bank in Chicago that can rediscount with the National Reserve Bank in Chicago or with the leading banks in New England or in New York, will not find it necessary any more in the future to keep so much on call money in New York as it did in the past. As a matter of fact, it probably will hold a large amount of bills and keep very little money on call, and only as much as it needs for its daily requirements, unless rates in

New York would be exorbitantly high and would offer a stimulus for accumulation in New York. But, if you think it necessary you might provide that banks in Central Reserve cities should segregate such reserve funds, and keep a gradually increasing proportion of them either in cash or as balances with the National Reserve Bank of their city, or in rediscountable bills of exchange. I dis advise being too drastic in withdrawing *all* reserve money from the Stock Exchange; the country will be the sufferer if the organ which absorbs and digests securities should be maimed! By that, I think, the framers of the law would achieve just what they intend. I do not believe in earmarking money for each locality; what we want are reserves and a currency that will flow where needed in the country. What I would suggest is, that, in addition to the provisions which I have just outlined, it be provided in the law that every bank becoming a stockholder and a member of the National Reserve Bank be obligated to maintain a certain percentage of the reserves to be kept by law, as a balance with the National Reserve Bank of its locality.

COUNTRY BANK POSITION

The country banks at present hold reserves of 15%, of which two-fifths, equal to 6%, must be kept in cash, three-fifths, equal to 9%, may be kept in deposits in reserve cities. I would suggest that of the 6% that now must be kept in cash no less than 5% must be kept as a balance. If amounts larger than the remaining 1% in cash are required for the daily needs of the country bank, these will have to be withdrawn from the 9% which now may be held on deposit, and for Reserve Banks it might be provided that out of the 12½% which must be kept in cash, a balance of say no less than 10 or 11% should be maintained as a balance with the National Reserve Bank, the balance of 15% or 14% would be kept as cash or on deposit in Central Reserve places. Cash and cash balance must be no less than, together, 12½%. For Central Reserve Banks one might stipulate that no less than 20% out of the 25% should be kept as a balance with the National Reserve Bank.

There is no need for large cash holdings in the vaults of the banks, as long as they can always manage to receive cash from their National Reserve Banks against rediscounting their short paper. I believe that, if a modus as suggested here, would be applied, a very important step towards the establishing of discount markets would be achieved and, incidentally, the National Reserve Bank organization would be considerably strengthened, because you would fix a definite percentage

for the deposits of the banks with the National Reserve Banks. The whole structure would thereby gain in strength while the Aldrich Plan in this respect, leaving the balances entirely indefinite, was very weak. While in principle I agree that keeping balances in Reserve Cities and Central Reserve Cities, and counting those as cash, is not very sound banking theory, we must not forget that this is something to which our country has adapted itself, and, as a matter of prudence, it is very desirable not now to interfere in a radical way with this machinery. If after the new system has established itself, later on, and when discount markets have been organized, it should prove feasible and desirable gradually to reduce these balances, it can always be done by ulterior legislation. For the time being, the country banks and the banks in reserve cities would all violently oppose any legislation that would too radically interfere with the present system in this respect. (It may be that all this is just what the draft of the law means; but, as stated, I do not understand it.)

TREASURY

The depositing of the treasury balances would offer little difficulty if my suggestion will be carried out that there should be only few units. I doubt the wisdom of allowing interest to the Treasury on its deposits, inasmuch as nobody else received interest on deposits. But this is a matter of minor importance only.

I do not see in the present Bill that the various National Reserve Banks are to be mutually responsible. This is a necessary requirement, but it will be impossible as long as we deal with a large number of small units. If we deal with a few large units, there will not be any difficulty in securing the willingness to be mutually responsible for each other. I do not see that the profits of the National Reserve Banks are limited to a certain percentage; the balance going to the Government. This is absolutely necessary.

I do not see that any liquidating fund is mentioned in the plan. I think it would add to the attraction of the plan if a surplus fund would be established which would have for its object to pay off depositors of banks in default, up to such a percentage of their claims as would be safe considering the existing assets of such a bank. The National Reserve Banks might act as liquidators in such cases, eliminating protracted receiverships. This would eliminate the main hardship which defaults bring to depositors of a bank, that is, the unnecessary tying up for a long time of the deposited funds; the ultimate loss which falls upon them is in most cases not so important.

There are a great many phases which I have not touched upon, because I have tried to discuss only the main points at issue. It is necessary to agree upon those before we may go into the details of the questions.

I am afraid my criticism is more voluminous than I would have wished to make it, but you have asked me to give you my opinion within a day or two, and I therefore have not sufficient time to condense it, so as to please both you and myself. If there is anything else I can do to further this matter, kindly let me know.

When Was Memorandum Revealed?

The question when and how the Federal Reserve Act first got into the hands of the financial interests generally, or in current vernacular, of "Wall Street," has been greatly discussed and deserves a few words. In the foregoing treatment it has been made clear that up to the time when a digest of the Federal Reserve Act had been prepared at the request of President Wilson and had by him been given to Colonel House, who showed it to one or more financiers, there had been no distribution or dissemination of the bill. Colonel House's consultations were undoubtedly the first occasion upon which a definite digest or a written draft of the whole or any part of the measure was conveyed to the financial public.

As has been fully noted in foregoing chapters, it had been the policy of Chairman Glass to state frankly to all authoritative persons who made inquiry the general lines along which his Committee was working, but in no case to give out statements about it for publication or to furnish written drafts purporting to represent the contents of the measure. In all of the early drafts of the Federal Reserve Act, or of special sections of it which were made from time to time, three copies only were written. Of these the first or original was placed in the hands of President Wilson, the second in those of Chairman Glass, while the third was retained for filing and reference purposes. All efforts to obtain either an op-

portunity to read or copy any portion of these preliminary bills or drafts had failed.

Circulation of Digest

How widely the digest furnished to President Wilson eventually obtained a circulation among the financial community, and at whose hands, it would be difficult to say, but there were indications at an early date that it had been read by a good many persons. The inflow of letters treating of points "said to have been" incorporated into the new bill increased very greatly and there were other indications that something had been done to bring pressure upon the members of the Committee from a variety of sources. The mere fact that no banking and currency committee was actually named until several months after the opening of the new session was of course of little importance, since it was assumed that all of the old members still in Congress would be reappointed—as in fact they were. Nevertheless the policy of refusing to issue the bill until such time as it had been admitted for consultation was adhered to.

Probably the first copy of the bill allowed to get out of the hands of those immediately concerned in its preparation was given by Secretary McAdoo to Colonel House early in May. Mr. McAdoo at an informal gathering called for the discussion of some phases of the pending legislation said that despite the injunctions of secrecy which had surrounded the bill, he thought it had reached a sufficiently advanced stage to permit of its being more widely read and that he had therefore furnished a copy of it to Colonel House, who had sailed for Europe on the preceding day. At the same time as the departure of Colonel House, Mr. Paul M. Warburg sailed for Europe and from Switzerland sent back criticisms upon the measure designed to show its unavailability, which were privately distributed in printed form to a considerable number of bankers. It is probable that from about this time onward

the extreme secrecy which had surrounded the exact terms of the measure was gradually broken down, despite all efforts to confine it within a narrow circle until its terms had been fully agreed upon, so far as those who were engaged in the preparation and reviewing of the measure had any power to come to an understanding on such a subject. But the bill did not at any time reach the general public through the press until it was ready for publication several weeks later. It was this secrecy which later aroused so much severity and bitterness of criticism and which was so seriously misrepresented. It should, however, be noted that at no time was there any secrecy as to what was being done or proposed, although, as already fully explained, every effort was made to prevent the language of the text that was being formulated and the details of its terms from being widely distributed.

Avoidance of Secrecy

- Let it be again emphatically stated at this point that the reason for this policy on the part of the Committee was based on the experience of the past which had shown that the difficulties with all such legislation were found in the attacks of special interests upon individual provisions. When once an essential section of a measure was changed, changes were necessitated in other sections and the whole proposed enactment speedily became a series of special bargains. In the case of the Federal Reserve Act it was desired, if possible, to maintain it as a consistent whole up to as advanced a stage of its development as possible and as matters turned out this design proved to be feasible. It in a way was the salvation of the measure by keeping it consistent with itself and in the main honest and straightforward.

CHAPTER XI

FRAMING AN "ADMINISTRATION BILL"

Situation in May, 1913

The situation at the beginning of May, 1913, was thus practically as follows: The proposed banking bill had been examined and tentatively approved by President Wilson and had been at least thoughtfully considered by some of his principal advisers, including Secretary W. G. McAdoo and Colonel House. It had, moreover, as already seen, been conveyed in its essence, although probably not in textual form, to some of the Wall Street financiers who had concerned themselves with the legislation and with the currency movement in general. The preliminary survey of the new measure which had thus been allowed to get into the hands of New York financiers, immediately aroused opposition, and rumors concerning it began to spread rapidly in the Street. Strong opposition to it was expressed in letters written to various members of the administration, and the Secretary of the Treasury became disposed to favor a substitute of some sort.

A New Phase

A new phase of the development of the bill was now about to open. Secretary McAdoo had formed the opinion that the proposed bill would be acceptable neither to the Wall Street interests nor to the so-called "Bryan element" in the Democratic party. He feared that it would fall between two stools and that thus falling it would receive no support from either wing of extremists, while the great mass of the people, knowing little of the subject and fearing anything that might be

used in a skilful appeal to their prejudices, would either remain silent or be hostile. Under these conditions Secretary McAdoo determined to undertake the preparation of a bill of his own, and to secure the indorsement of President Wilson, thereby making an "administration bill." In casting about for a basis of work Mr. McAdoo, after considerable reflection, determined to commit himself to the idea of government operation of the proposed new banking system, while he further undertook to compel or induce the existing national banks to furnish the capital required by the enterprise. On the other hand he determined to invoke the aid of the Bryan wing of the party by a return to the greenback ideas of former years. Either as a result of his own work or with the co-operation of members of the Treasury Department, among whom was undoubtedly John Skelton Williams, then Assistant Secretary of the Treasury, he prepared the outline of a new banking plan which was to be put forward as a substitute for the Glass bill.¹ An outline syllabus or summary of its provisions was prepared and this was distributed to a considerable number of bankers.

Forms of Proposal

As a result of changes which followed upon criticisms and suggestions this syllabus assumed various forms and it is probable that the shape in which it was submitted to the different bankers was not exactly the same in every case. The

¹ Preliminary to this attempt to frame a new bill there occurred a conference in Washington at which were present the Secretary of the Treasury, the then Assistant Secretary of the Treasury, Mr. J. S. Williams (later Comptroller of the Currency), Mr. Glass himself, and the writer. This conference occurred at a Washington club house and at that time it was suggested that perhaps the preliminary draft of the Glass bill was not as satisfactory as might be, and that a revision of it, designed to effect certain changes in the plan, would be necessary. Mr. Glass had expressed entire readiness to introduce any changes that might be necessary or to have redrafted such portions of it as might be desired for the purpose of bringing out any points of view or including new material such as might be suggested. A few points of improvement were tentatively mapped out and orders were given to proceed with a tentative redraft of these topics. These redrafts, however, were never called for, but shortly thereafter it was learned that Secretary McAdoo had met various bankers in conference in New York and had proposed to them a plan outlined in a brief memorandum which he submitted and which was later said to have originated with Mr. J. S. Williams or to have been jointly evolved by Messrs McAdoo and Williams.

plan at the outset was primarily a currency plan providing for the retirement of national bank notes and the substitution of government issues in lieu thereof. This was clearly intended to meet the demands of the Bryan group, which had all along urged the issuance of government currency. But this plan was not sufficient to meet the requirements of the banking public and hence the incorporation into it of a rather vague provision for the establishment of reserve banks which were to be kept few in number as had been demanded by the bankers. Another and somewhat incongruous element was the proposal to establish a currency commission and alternating with it the notion of a government central bank with a number of branches or agencies to be managed by a national reserve board with various sub-boards operating under its direction. Exactly how far, as already intimated, this proposal or series of proposals really represented the ideas of the Secretary of the Treasury, it would be impossible to state with absolute accuracy. The plan became known as the "McAdoo plan" because it was presented and urged upon bankers by the Secretary of the Treasury.

It may be questioned how far President Wilson was conversant with this substitute for the measure proposed by Chairman Glass and worked out with his own personal approval. The plan showed traces of the views expressed by various of the President's political advisors but the indications were that the Executive himself had at most done no more than sanction the attempt to experiment with the scheme. This, however, involved a very considerable hazard. One of the outlines of the new plan was as follows:

CIRCULATION AND GOLD RESERVE

The United States Treasury shall agree to purchase 2% bonds now held by national banks, at a price of 102, applying so much of the purchase money as may be necessary to the redemption of outstanding circulation of the selling bank.

In exchange for bonds thus purchased by the Treasury, there shall

be issued new national currency notes, which shall be substituted as rapidly as may be for the national bank-notes received for redemption. So fast as United States notes and gold certificates are received at the Treasury, either for redemption or for public dues, they shall be cancelled and new national currency notes shall be issued in exchange.

The effect of these provisions would be ultimately to substitute national currency notes for the following existing issues:

Gold certificates	.. \$	985,504,241
United States notes	...	346,681,016
National bank-notes	...	<u>752,059,332</u>
Total	...	\$2,084,244,589

A 50% GOLD RESERVE

It is proposed that against this entire volume of new national currency notes, there shall be held a government reserve in the Treasury of not less than 50%. The amount required for such a reserve would be \$1,042,122,294. Available for this purpose would be the following sums in gold:

Held against gold certificates	... .. \$	983,504,241
Held against U. S. notes	... ..	150,000,000
Free gold in Treasury (May 24, 1913)	...	<u>103,500,446</u>
Total	...	\$1,237,004,687

This amount is simply sufficient to constitute the 50% reserve required. It is to be noted that it results in the substitution of a currency covered 50% by gold for the existing national bank-notes, against which the required reserve is only 5%. The additional gold is obtained by reducing the percentage held against gold certificates from 100% to 50%, and this gold is employed in buying the bonds now held by the national banks to secure circulation, and compel them to retire the existing bank-notes with the national currency notes paid for the bonds.

The taking up of about \$700,000,000 in 2% bonds would relieve the government from an interest charge of \$14,000,000 annually for all time to come.

ELASTICITY OF THE NEW NOTE SYSTEM

In order to prevent inflation by the act of any government official, even exercising what he considers to be his best judgment, there should be no way of increasing issues of national currency notes (other than those provided by the plan as already outlined) except by the voluntary action of the banks as representatives of the business

community. The government, if allowed to issue notes upon all deposits of gold to the amount of double the deposit, would be the gainer in assets of 100% of the amount of gold deposited, because it could issue \$200 in notes for \$100 in gold. It would be extremely dangerous and unsound, however, to permit the government to issue such notes except upon application from banks upon first-class assets, and it would be unwise to permit covering such profits into the general funds of the Treasury except under special conditions. To guard against this danger, it would probably be wise to allow the excess gold to accumulate in the issue department of the Treasury until the amount held against notes was 60% instead of 50%. It might then be proper to authorize the National Currency Commission, hereafter to be referred to, to apply the excess of assets above 60% to the reduction of the public debt; but even this should not be mandatory, but should be optional with the Currency Commission and should be governed by the conditions of the money market and of the foreign exchanges. Under the operation of such a system, however, the steady accumulation of gold would probably result in the ability of the Currency Commission to gradually extinguish the public debt remaining, after the proposed plan went into execution, by the purchase of bonds in the market or their payment at maturity.

TAX ON EXCESS NOTE ISSUES

It is probably desirable, in order to prevent the fear of unrestricted inflation of both currency and credit, to impose a tax upon such issues of notes as are not covered by a gold reserve of 50%. In this respect, it would probably be advisable to follow the German system, imposing a tax at the rate of 5% upon national currency notes issued by the Treasury whenever such additional circulation was issued to one of the reserve banks upon commercial paper and not upon the deposit of gold. It might or might not happen that the issue of such notes would reduce the Treasury reserve below 50%; but if they were subject to a tax of 5% they would be cancelled as soon as the special pressure was over which led to the demand for them.

Such excess issues should be made only with the approval of the National Currency Commission and upon application of a reserve bank. Such bank should be relieved from the payment of the 5% tax only so far as it deposited national currency notes or gold to cover the taxed circulation. In this way, the Treasury gold reserve would be replenished, or (what is the same thing) outstanding notes would be reduced.

Under this provision, it would be at the option of the reserve banks to import gold in order to increase their note issue and their loans; to pay the tax upon the deficiency of their own reserves, as set forth below; or to take out notes under the tax of 5%. Whether one course or the other were adopted would depend upon the character of the demand for additional currency and the state of the money market and the foreign exchanges. The reserve banks would be free to import gold or to pay the tax upon the deficiency in their reserves according to the judgment of their own governing boards; but they could obtain additional currency notes only with the consent of the National Currency Commission. As a rule, the managers of the reserve banks, being as a body under the control of the National Currency Commission, would probably act in harmony with that commission in taking any steps to obtain additional notes or to reduce their reserves; but there would be a variety of means of dealing with any given problem which would permit a certain latitude of judgment.

RESERVE ASSOCIATIONS AND NATIONAL CURRENCY COMMISSION

There should be created about five reserve association banks, with headquarters in New York, Chicago, St. Louis, New Orleans, and San Francisco. The capital of these banks should be raised by a subscription of 10% of the capital of national banks, which banks should be permitted to subscribe to the capital of the reserve bank only upon accepting all the conditions of the new Currency law.

There should be constituted a National Currency Commission to which should be committed the custody of the reserve funds of the Treasury and also the administration of the reserve funds, the rediscount policy, and the fixing of the rate of discount of the reserve banks. Their powers should be so clearly defined and so ample that they could exercise an influence over the foreign exchanges and the movement of gold similar to the administration of the Bank of France or the Bank of Germany.

The National Currency Commission should be so made up as to contain several representatives of the Government, like the Secretary of the Treasury, the Comptroller of the Currency, the Director of the Mint, and the Treasurer of the United States, or their deputies; but it should also contain the heads of the five reserve banks or their deputies and enough other representative bankers to ensure the condition that the policy of the Commission should be determined by business considerations and not influenced unwarrantedly by political considerations.

FUNCTIONS OF THE RESERVE BANKS

The reserve banks should be permitted to grant rediscounts to reserve banks (and perhaps to other classes of banks) so long as they maintained a reserve of 50% against deposits in national currency notes or gold. For the purpose of their relations with the Treasury, it would be immaterial whether their reserve against deposits consisted at any particular moment of notes or gold, because they would be able to convert notes promptly into gold by presenting them for redemption in case there was a demand for export, while they would be able to obtain notes for gold in case of an interior demand for currency. It would probably not be advisable to require them to hold any particular portion of their reserve in gold coin or bullion, because this would handicap their ability to issue currency in the form of paper, in which form currency seems to be preferred in this country.

The operation of this system would be that when a demand arose for rediscounts, it would be met by the reserve banks at first, only to the extent that it did not reduce their reserves against deposits below 50%. If the demand became more urgent, however, the reserve banks would be compelled to import gold or could be permitted under certain conditions to allow their reserves to fall below 50% under certain taxes—say:

Below 50%, a tax upon the deficiency of reserves of 2%.

Below 45%, a tax upon the deficiency of reserves of 5%.

MANNER OF DEALING WITH EXISTING BANK RESERVES

In order to afford existing national banks some degree of compensation for the loss of the interest which they now derive from United States bonds, and in order at the same time to facilitate the concentration of lawful money reserves in the reserve banks, it would be possible to make some readjustments of the existing reserve laws, which would release a certain amount of cash, without imposing serious losses upon the banks in connection with the interest which they now receive upon reserve deposits. The entire system of paying interest upon reserve deposits is unsound and should ultimately be done away with entirely, if practicable. To propose its immediate abolition, however, would arouse hostility on the part of practically all the country banks and tend to make it difficult to enact new legislation. For these reasons, it is suggested that the requirements in regard to lawful money reserves be made as follows:

PROPOSED RESERVE REQUIREMENTS

(Per Cent)

Classes of Banks	Cash	With other Banks	With reserve Banks	Total
In central reserve cities... .	10%	.	15%	25%
In other reserve cities.....	10	5%	5	20
In country banks.... .	5	10	....	15

The effect of these readjustments of reserve requirements (based on the reports of the national banks to the Comptroller of the Currency for April 4, 1913) would be to reduce the cash requirements of existing national banks from about \$888,000,000 to \$539,000,000 and the requirements of deposits in other national banks from \$552,000,000 to \$463,000,000. The amounts thus released would become deposits in the reserve banks to the amount of \$337,000,000. The real cash position of the national banks would not be weakened, as compared with the present condition, because against the \$750,000,000 of existing national bank notes now in circulation with very small cash reserves there would be in circulation the same amount of national currency notes, covered by reserves of \$375,000,000 in physical gold. This would make the total gold resources held against what may be called the existing liabilities of national banks \$914,000,000 instead of \$888,000,000, as at present.

Criticism of McAdoo Plan

Although the McAdoo plan was not at first placed in the hands of Chairman Glass, it eventually became known to Mr. Glass. Secretary McAdoo sent a copy of the outline to the expert of the Committee, asking for his views with regard to it, and after consultation with Mr. Glass a memorandum designed to deal with the proposals then pending in administration circles, and particularly with the McAdoo plan as a type or sample of them, was prepared. This memorandum was directed against the proposal for a "national reserve" which represented the fruition of the McAdoo plan—one of the schemes which had been developed from it as time went on. The memorandum was transmitted to Secretary McAdoo and to the President and practically constituted the expression of the views of those who had been interested in the further-

ance of what afterwards became the Federal Reserve Act. This memorandum ran substantially as follows:

A CENTRAL BANK

1. The memorandum in question provides for the organization of what is practically a government central reserve bank with 15 branches or agencies, the whole to be managed by a National Reserve Board with sub-boards controlling each reserve agency under its general direction, the capital to be furnished by existing banks through the purchase of "certificates of beneficial interest" bearing 4 or 5% interest. These certificates would be purchased by the banks, the national institution being required to buy them to the extent of 10% of their capital. In substance this is a plan for the establishment of a Government central bank upon a capital to be furnished by private concerns. The first question is: Would it be practicable? On this point I am perfectly clear. There is no reason why the Government should not start and operate a central bank of its own entirely free of banking influence or control. The plan could therefore be put into operation and the fact that the Treasury is now the possessor of such immense funds would give the institution a power and prestige unexampled in this country. I am equally clear that the plan would be highly undesirable and I am of the opinion that it could not be successfully carried on. A few of the reasons for this belief are:

(a) The Government is not successful in other business enterprises.

(b) The Government is unable to get or at least does not get satisfactory ability for the management of its present industrial undertakings, and there is no reason to think it would do so in this case.

(c) Experience here and elsewhere shows that institutions in which the Government has too large a part are subject to political control, than which nothing could be more disastrous in the extension of credit.

(d) In this particular plan, I have no idea that the national banks would buy the certificates in question as the terms would be far from attractive under the circumstances. They would become state banks and the Government would either have to do business with them or extend the benefits of the national reserve only to a small clientele.

(e) No such plan ought to be put into effect at all unless the Government is prepared to extend the operations of this national reserve to dealings with individuals. The Government is not a Government of, for or by banks but is a Government of men. One of

the greatest defects and weaknesses of plans that are currently put forward is that they do not guarantee the transmission of their benefits to individuals because the only customers at the reserve institutions are to be banks. This condition is endurable where banking is carried on by private corporations but it is not tolerable that the Government itself should establish a scheme of this kind simply for the benefit of banking institutions.

(f) If however such a plan is to be inaugurated at all the mechanism outlined in the memorandum would then when completed and filled out, doubtless be adequate to the purpose, provided that the capital needed were obtained either by the method suggested or by some other.

RESERVES

2. As to the reserve requirements suggested in this memorandum I consider them wholly inadequate. The reduction to 15% flat throughout the country goes much too far. We may fairly estimate that under the Owen bill the total possible bank inflation would be perhaps \$6,000,000,000. It is not probable that anything like this would occur under the national reserve plan because the latter requires the maintenance of at least some cash in the vaults. The plan would, however, certainly permit a very great expansion of bank loans and this, it would seem, could not be less than about \$2,700,000,000. While it is true that the memorandum provides for the adoption of regulations by the National Reserve Board with reference to reserves, it is not indicated what these would be exactly so that the plan must be looked upon as going much too far.

UNIFICATION OF CURRENCY

3. As to the provisions for unification and issue of circulation upon a national gold reserve it seems to me that they are calculated to cause very great alarm. As I understood the plan calls for the conversion of bank notes, greenbacks, and gold certificates into a uniform currency to be issued to twice the amount of gold available, such amount being estimated at \$1,435,489,000. This is evidently founded upon the assumption that the gold certificates, etc., could be obtained without material trouble in order to convert them into the new kind of currency. I do not believe there is anything to warrant such a belief, but on the contrary I think that gold would promptly be hoarded by banks and others were such a plan as this to be announced. The plan therefore could start only with a comparatively limited basis and it would be successful only so long as the credit of the Government

was high, its revenues large and conditions stable. Experience in the past shows that that is a condition that cannot be expected to continue indefinitely. Wherever Governments have gone into the issue of paper the experiment has ultimately turned out disastrously. War or other disturbance would immediately lead to the inflation of this currency and probably to ultimate suspension of gold payments.

MODE OF ISSUE

3a. As for the method of issuing this currency to banks upon a pledge of commercial paper to be put up by such banks while requiring the banks to hold gold equal to one half of the notes they got, it is very difficult to see from the memorandum just how the details of the plan would be worked out in practice from the technical standpoint. Assuming that all such difficulties were not met however, there is little objection to be made to the methods by which the banks would get the notes and put them into circulation as they are sufficiently safeguarded to prevent the banks from calling for an undue over-issue of the notes. The danger is not there but is in the method of their issue by the Government and in the fact that they are ultimately an irredeemable paper currency. In saying this it is of course assumed that these notes since they are lawful money could be used as reserves in banks in which case they would furnish the basis for very serious inflation. The idea suggested has a close resemblance to that put forward in the Aldrich Plan, except that there the note issues which were to be used to pay for bonds now held behind National bank notes were to be those of the central reserve association which was sustained by the banks themselves. While the technic is very similar in the two cases, however, the method followed in the present plan is even more objectionable than in that of the Aldrich plan. Both plans would have resulted in maintaining the present redundancy of circulation and in overloading the proposed institution with responsibilities which it cannot well take care of. The whole question of solvency would depend upon whether the Government was able to maintain the 50% reserve behind the notes. This as already stated would depend upon a great many elements.

POWERS OF NATIONAL RESERVE BOARD

4. With reference to the proposed powers to be conferred upon the national reserve board, they are, of course, in summary outline those that would have to be exercised by such a board or by any central banking or central bank supervising agency. There is there-

fore nothing to say with regard to them until they assume a detailed form. The same is true of the section dealing with earnings which follows the generally accepted lines.

CHANGES IN BANK LAW

5. As to the liberalization of the national bank laws it is earnestly to be hoped that nothing of the kind will be done. What is urgently needed in the United States is the creation and strengthening of a solid corps of strictly commercial banks. The state banks and trust companies perform all the general loaning functions that are recommended for those who call for liberalization and it would be unwise to let the national banks drop into the same general line of business. It is even to be doubted whether the permission to make loans on real estate even to a moderate amount is admissible for the national banks.

6. The memorandum in a paragraph dealing with "Objections" discusses the assertion that the proposed plan would put the Government into "the banking business" and rebuts it. It is stated that the Government is already in the banking business to a large extent, that the proposed plan simply puts it directly into the business where it is now only indirectly engaged, and that it would under the suggested scheme, simply extend its direct banking functions somewhat further than has ever before been proposed. It is pointed out that many of the plans currently suggested for banking organizations are cumbersome. The latter point is well taken but the cumbersomeness is due to bankers' opposition to anything better. This same opposition would exist with reference to the national reserve plan. It would be very simple to frame a straightforward direct scheme of reform if bankers' opposition could simply be ignored. That cannot be done and those who have framed the national reserve plan cannot ignore it any more than any one else. The proposed plan reverses the current of discussion on banking reform and takes the Government more and more into the banking business instead of getting it out. And yet it does not have the thoroughgoing quality that would lead to the direct establishment of a Government central bank doing business with the public and making direct loans to individuals. There is no reason whatever why it should not do this except the fear of banking opposition. And there is every reason why it should not establish a loan institution for the sole benefit of bankers even if the surplus earnings are turned in to the general public Treasury. There is every reason to think that the "temper of the American people" referred to in the memorandum would be very strongly against any such use of

public funds if the Government went directly into the banking business. The case is quite different so long as it merely exercises a supervisory control of banking and places its funds with banks on deposit.

GENERAL CONCLUSION

In a word, the "National Reserve" plan although in its outlines sufficiently feasible and workable would be found in practice to be difficult to start, perhaps impossible, owing to the distrust and lack of confidence which would be inspired by it and the hoarding of gold. It would be difficult to conduct successfully and even if successfully carried on would be for the benefit of a given class only. It would be subject to the danger of breakdown upon any sudden strain of public credit. Even if none of these objections held good it would probably be politically impossible and its hazard as a direct programme would be enormous.

Proposal Unsatisfactory

Record should be fully made of the fact that this plan never assumed a fully considered form and was never put into shape as a bill or even completely drafted in such a way as to deal with the various points of technic and detail. It can be considered only as a scheme or proposal, and as such it represented a curious combination of disposition to concede what the inner banking group desired, combined with effort to bring about a compromise with the radicals who were chiefly interested in keeping the currency under the control and direction of the government. In one sense the McAdoo plan may be regarded as the only outcome of that financial or "Wall Street" criticism upon the Glass plan which was considered by the administration as voicing the views of the financial interests, since it embodies what had been laid down as a cardinal principle, the limitation of the number of reserve institutions to not more than four or five. It, however, had no effect upon the Glass bill and at no time was there any serious effort to modify the latter measure by amalgamating the essentials of the McAdoo scheme with it. For the time being, therefore,

both this scheme and the criticism referred to, coupled with the later suggestions from time to time put forward from the same sources, entirely failed of even a temporary effect. As a matter of fact the final measure itself contained substantially nothing that could be regarded as having been carried over from either quarter.

Political Situation

Secretary McAdoo's plan was, however, undoubtedly an important new factor. The President, having committed himself to the Glass bill, was now faced with the fact that his Secretary of the Treasury, aided by the Comptroller of the Currency-to-be, had prepared a plan radically different from the Glass proposal, although drawing upon it for some of its chief ideas. It was an embarrassing and difficult situation for Mr. Wilson. Above all things he at that time desired party harmony and above all things else he desired party harmony on banking and currency. It was almost a political necessity to attain such harmony, and yet the action of Secretary McAdoo threatened it gravely. The substitution of the McAdoo plan of course could not be acceptable to Chairman Glass, nor, as the plan was framed, to any of the so-called "sound currency" wing of the Democratic party. It was an unfortunate interlude in the process of developing the currency measure—one which probably delayed progress by several weeks at a time when haste was imperative if there was to be any action.

What form the McAdoo measure might have taken had it been agreed upon in principle and had it been ordered put into actual draft form, it would be impossible to say. The provision for a legal tender note issue, the plan to expropriate the holders of gold certificates, the effort to put the government direct into the banking business, and various other features of danger would certainly not have been an offset in the minds either of radicals or of conservative thinkers on banking and

currency for the fact that the bill proposed to retain the old system of redeposited reserves which the Aldrich bill had kept and which had been the principal source of difficulty under the national banking system. The fact that the number of reserve banks was to be cut to five would probably in no way have been regarded by the financial community as compensation for the putting of the government into the banking business, the redemption of the government bonds with legal tender notes, or for other features designed to please the extreme left wing of the party and certain to cause serious trouble.

President's Decision

The whole matter finally came to a head at an interview in which Chairman Glass plainly brought to the attention of the President the facts regarding the attitude of the bankers of the country with respect to the McAdoo measure and pointed out to him the dangers involved in the scheme. The fact that the bill had already gone into circulation and had been unfavorably received by the bankers was unquestionably a surprise to Mr. Wilson, and after somewhat further consideration of the matter he announced his intention of definitely pigeonholing the McAdoo-Williams plan and of continuing his adherence to the Glass bill. This determination on the part of the President promptly led Mr. McAdoo to a straightforward undertaking to support the Glass measure during its passage through Congress.²

² A copy of the McAdoo proposal having come into Mr. Glass's hands and into those of the author, at Mr. Glass's request the author asked Mr. A. B. Hepburn, president of the Chase National Bank, to sound some of the bankers of the country with reference to the probable effect of the scheme and supplied him with copies in order that he might transmit one to each person thus interrogated who had not received it direct from the Secretary of the Treasury. Shortly after the request was thus transmitted to Mr. Hepburn, replies began to come in both to Mr. Glass and direct to the President. They were almost uniformly adverse, bankers, including Mr. J. B. Forgan of Chicago and others, expressing themselves in exceedingly strong language. Apparently the centralization idea as set forth in the McAdoo plan appealed to them either very little or not at all. What did strike them was that the plan if carried out would have resulted in making the government participate directly in the practical operation of banking, while it would have implied the almost immediate issuance of an enormous volume of currency equivalent in status to the already existing greenbacks. Neither of these features was regarded by the bankers as at all tolerable and the consequence was that they in every case as far as could be learned flatly rejected the scheme.

Secretary McAdoo, however, believed that he had obtained the support of George

Criticism of the Glass bill which had culminated in the McAdoo proposal was not, however, fully ended. Secretary McAdoo referred the measure to the Solicitor of the Treasury, the Director of the Mint and to various others. Whether expected that any of these opinions would be decidedly verse or not, would be only a matter of conjecture. The rector of the Mint at that time was Mr. George E. Roberts, bsequently vice-president of the National City Bank and for any years a conspicuous factor in the Republican party. His port on the bill, however, was gratifyingly strong, heartily proving of the general outlines of the measure and describing it as "sound and conservative, following well-recognized inciples." No publicity was ever given to this opinion rendered by the Director of the Mint, nor was any given at the ne to the views of the Solicitor of the Treasury, W. T. Thompson. Both (and particularly that of Mr. Roberts) are historical value and significance, since they threw a light on the measure which had not been expected at the time. ey (and particularly the opinion of Mr. Roberts) were rectly in defiance of the views expressed by partisan Republicans immediately after the bill became public as well as in position to those of many subsequent critics. The immediate fect of the Thompson and Roberts opinions within the administration was to confirm the Glass bill in the position which then occupied. They were shortly transmitted to Mr. Glass d served to strengthen him in the view already entertained at the measure as prepared for introduction in Congress ould be able to endure the attacks of critics.

upport of Officials

With the laying aside of the McAdoo measure and with the ceipt of the opinions of various officers of the government

Reynolds of Chicago and of sundry other bankers. He had several meetings with nolds and others in New York City and discussed with them in great detail the ration of his proposed measure. Some tactful bankers left him under the impression that they considered the scheme at least measurably sound, but in conversation h their professional associates they assumed an entirely different position.

to whom it had been submitted the Glass plan practically received definite adoption as an administration bill. President Wilson himself still entertained some doubts, or so it would seem. He sent it to Secretary of Agriculture Houston and to Franklin K. Lane, Secretary of the Interior, who, it was understood, referred it to Mr. A. C. Miller, then his assistant, and later to be appointed at his instance a member of the Federal Reserve Board. The opinions of both Messrs. Houston and Miller appear to have been noncommittal or perhaps mildly favorable. They never took form in any written communications to the Banking and Currency Committee and if they made recommendations or suggestions the Committee never heard of them in any official way. President Wilson, satisfied at last that the measure was worthy of serious support, now necessarily faced the problem of obtaining for it the pledge of the party organization in the Senate and the all-important support of Secretary of State W. J. Bryan, the real leader of the powerful "left wing" of the Democratic party. Without these two accessions to the support of the measure, it was clear that no progress could be made. To permit a conflicting bill to appear in the Senate, perhaps to pass that body, then to be sent to Conference with the Glass bill which might in the meantime pass the House, or possibly to be transferred to and pressed upon the House as a substitute for the Glass bill, would have been unthinkable—fatal to the getting of any well-rounded or consistent legislation. It could not be considered for a moment. On the other hand the adoption of the Glass bill in the House of Representatives might about as well be abandoned unless the Bryan element could be induced to be either friendly or neutral. Since few if any of the Bryan members were constructive thinkers on banking and currency questions, it was believed that the only way to get their support would be that of enlisting the direct aid of Mr. Bryan himself, and this could be done only by explaining the bill to him with care, getting his suggestions and arranging a *modus vivendi*

which would insure at least a fighting chance for the measure when it emerged from committee. These problems the President now proceeded to deal with.

APPENDIX A TO CHAPTER XI

OPINION OF GEORGE E. ROBERTS ON THE GLASS BILL

GENERAL PLAN OF ORGANIZATION

Bill is sound and conservative, following well-recognized principles.

It provides for organizing the banks into a system through which they can protect each other and aid each other in the performance of banking functions, under strict supervision by the government and complete publicity. I think there can be no doubt that the system proposed would be safe and effective for the purpose.

It provides for regional banks with the directors chosen by an arrangement under which banks of approximately the same size are segregated in five classes and each class elects its own director. This seems to me the best plan yet devised to preserve the proper representation for the small banks. The big banks would be in a class by themselves.

Provision is made in the Reserve Bank boards for members who are not bankers but represent the general public.

The Reserve Commission which will have supervision over the Reserve Banks is composed of three ex-officio members, to wit: the Secretary of the Treasury, Secretary of Agriculture, and the Comptroller of the Currency; of three members specially appointed by the President, and confirmed by the Senate; and two members from each Reserve Bank.

An Executive Board is provided of 9 members, which shall have all the powers of the Commission. The ex-officio members and members appointed by the President would comprise 6 of the 9 members and be in complete control unless overruled by the Commission. It seems to me that this gives practical control to the Government. The Commission would not venture to force an issue with the Executive Board without having an exceptionally strong case.

The general provisions for organization and regulation seem to be excellent until section 14 is reached.

AUTHORITY OF COMMISSION

The Federal Reserve Commission should have more definite authority over Reserve Associations than is given by Section 14. It

should have authority to require the removal of officials for incompetency or dereliction and to require specific items which are open to criticism to be charged off and removed from the schedule of assets, or written down to their actual value. In short, the Act should require Reserve Associations to comply with all lawful directions of the Reserve Board. Finally, in the event of persistent refusal of Directors to conform, there should be authority to suspend the operations of the Association or have a Receiver appointed.

(Section 14, paragraph d.) A circulating note is only *one* way of extending a credit. It is always issued *after* the credit is granted or obligation incurred. When the note is issued the recipient has some claim upon the bank for cash, which must be met in some manner, either by giving its circulating note or by giving some other form of lawful money. The restriction should be against expanding credits, and is well provided for in the reserve provisions, power of regulating the discount rate, and restrictions upon class of paper. Ordinarily no other regulation is needed, but the provision of authority to prescribe the general policy would meet every need.

RESTRICTIONS UPON PAPER

It is not clear that the Reserve Association can take over the required amount of loans from present Reserve Banks under the stringent conditions of Section 15. It must be remembered that when the present Reserve agents begin to reduce their loans in order to transfer the country bank deposits the Reserve Banks must be able to take their place in the loan market to whatever degree is required to protect legitimate business. It is doubtful if it can do so if restricted to paper running only 30 days.

It must not be overlooked that this transfer of reserves involves considerable loss to country banks as well as to banks in reserve cities. On the basis of present country reserves with reserve agents the interest received on these balances is approximately \$6,000,000. This does not include surplus reserves. It was doubtless the fear of arousing bank opposition on account of this loss that led the Monetary Commission to leave bank reserves undisturbed.

TRANSFER OF RESERVES

The transfer of country bank reserves from present reserve agents is an important change and should be arranged with much care. The newly organized Reserve Banks must immediately receive enough deposits to make them self-supporting, but beyond that the transfers

should be made gradually. I suggest that during first year every country bank shall keep not less than one-fifth of its required reserve with the Federal Reserve Association. The remainder may be kept either in its own vaults or with any bank that is a member of a Federal Reserve Association. During second year raise the amount in Federal Reserve Association to one-third, and permit balance to remain as before. After third year require that all reserves shall be kept in own vaults or with Reserve Association, but not less than 5% with Reserve Association.

Section 31 says that the reserves shall consist of *gold or its equivalent*. What will be accepted as its equivalent?

Section 15 says that any Federal Reserve Bank may "receive deposits of current funds in lawful money, national bank notes, Federal Reserve notes, or checks, drafts, and other claims upon solvent banks."

It is quite desirable in publishing the statements of the Reserve Banks that the reserves should all be in gold or gold Treasury Certificates. The reserve bank must, however, accept all lawful money in payment of dues to it. It can probably work off the other forms of money with the co-operation of the banks.

RESERVE BANK NOTES IN COUNTRY RESERVES

The chief defect, as it seems to me, is that the plan provides no means by which the gold stock of the country can be gathered together in the Reserve Banks. We have the greatest stock in the world but have always made ineffective use of it, because, while the coin itself is mostly in the Treasury the certificates of ownership are scattered among all the banks, in tills, in the pockets of the people, and passing from hand to hand. This is clearly a wasteful use of gold, for the notes of the reserve banks would answer all these purposes equally as well. In the vaults of the Reserve Banks this gold (or the certificates) would be a veritable bulwark of defense for the entire banking situation. This cannot be accomplished unless the notes of the Reserve Banks are made good in the legal cash reserves of the local banks. The objection always made is that to do this would make possible undue expansion of credits, the local bank credit being based on the Reserve Bank credit. It is true that the "pyramiding" of credit is something to be closely guarded. We do not allow our 7,000 national banks to use each other's notes in reserves, although State Banks do use them. But the very purpose in organizing this new system of Reserve Banks with a strong supervisory control over them, under

complete publicity, is to have an authority which can be trusted with large discretion. The notes of every central bank in the world are good as reserves in other banking institutions of the same country. We can never get the full use of our great stock of gold unless we can get it into these Reserve Associations.

If the Reserve Bank currency was good in the local bank reserves the former institutions would be more imposing. A reserve of 25% will not look large in comparison with the reserves of Europe. The Reserve Banks could hold to all of the gold they receive and pay out nothing but their own notes for ordinary circulation. As pay-master for the Government they would give their own notes for all the new gold produced or imported.

MINOR SUGGESTIONS

3% bonds should be exempt from all taxation.

Reserve Associations should be free from local taxation, except for real estate.

Is there any provision for it to hold real estate?

As all profits above 5% are turned into the Treasury there should be no interest on Government deposits.

What about publication of weekly statement of condition of Reserve Associations? Also a consolidated statement.

In section 35 the language should be changed to make the shareholders clearly liable for double the par value of the stock. It should also be made clear that in the event of a transfer of stock with 60 days of failure all parties who owned the stock within that time shall be liable.

Respectfully,

(Signed) GEO. E. ROBERTS, Director of the Mint.

APPENDIX B TO CHAPTER XI

LETTER OF TREASURY SOLICITOR TO SECRETARY OF TREASURY IN ANSWER TO REQUEST FOR SUGGESTED CHANGES IN GLASS BILL

Department of Justice
Office of the Solicitor of the Treasury
Washington, D. C.

May 21, 1913.

The Secretary of the Treasury.

Sir:

I have carefully examined the "currency bill" prepared by Mr. Glass of Virginia, which you submitted to me a few days since, with

the request that I advise you of any changes that might seem desirable to be made therein, either to supply omissions, or to remedy what might appear to be defects, or to conform its provisions in any desired respect to the existing laws relating to national banks.

The most prominent feature of the bill is its provision, in Sec. 23, that all moneys in the general fund of the Treasury, and all the revenues of the government hereafter accruing, shall be deposited in "Federal Reserve Banks." These banks are private corporations which are to come into existence under the provisions of the bill; the stockholders to be exclusively national banks, State banks, and trust companies. There are to be not less than fifteen of these banks, and they are to be distributed over the territory of the continental United States. All disbursements of the government are to be made out of the public funds so deposited.

I am not aware of any provision of the Constitution of the United States that would prohibit legislation under which the entire revenues of the government must be committed to the keeping of private corporations. There is a provision that no moneys shall be withdrawn from the Treasury except in pursuance of appropriations, which provision seems to assume that all the public revenues will be, in the first instance, deposited in the Treasury of the United States, but there is no provision that they shall be so deposited; and I am not aware that the constitutionality of laws under which they were deposited in the United States Bank during the early part of the last century, has ever been questioned.

It is apparent that the provisions of the bill referred to are inconsistent with the general policy of the act of August 6, 1846 (9 Stats., 59), establishing the "Independent Treasury" or Sub-Treasury system of the United States. In so far as such of the provisions of that act, or of such acts as are amendatory thereof, or supplemental thereto, as are now existing laws, are inconsistent with the provisions of the bill, they will be repealed by the last section of the bill, which provides for the repeal of all laws inconsistent therewith. The question what provisions of existing laws relating to the Sub-Treasury system are inconsistent with any of the provisions of the bill, is one which, if the bill becomes a law, can finally be determined only by the courts.

It will be observed that the bill nowhere provides in what proportions the deposits of public revenues shall be distributed among the fifteen or more Federal Reserve Banks, nor what officer of the government shall be charged with the duty of determining such proportions and directing such distribution.

Many provisions are scattered through the federal statutes which require, in particular cases, the deposit of public funds in the Treasury of the United States, or in designated depositaries of the United States. These, so far as they relate to the mere place of deposit, will all be impliedly repealed by Sec. 23 of the bill, which requires the deposit of all public funds in the Federal Reserve Banks. If the bill becomes a law it will at once become the duty of many hundreds of receivers of public moneys to make deposits of such moneys in these banks, but there will be nothing to indicate to them respectively in what particular Federal Reserve Bank the deposit must be made. Presumably the idea is that the deposit shall be made in the bank for that Federal Reserve District in which the money was received; but if that idea should be carried out it might result in the overloading of a bank in one district, and the impoverishment of the banks in the remaining districts, and impose upon the overloaded bank the heavy burden of providing a sufficient clerical force to keep the accounts made necessary by its disbursement of public funds. It seems to me that the bill should contain a provision authorizing the Secretary of the Treasury or the "Federal Reserve Board" to make regulations governing the apportionment of the deposits of public funds among the several Federal Reserve Banks, and the deposits of public moneys in such banks by the various receivers of public moneys throughout the country.

Practically, to many intents and purposes, the Federal Reserve Banks would be a part of the Treasury of the United States, though the bill does not declare them to be such. If the bill should become a law, possibly questions might arise in the future, where public moneys had been paid into or disbursed from a Federal Reserve Bank, as to whether such moneys had been paid into, or disbursed from the Treasury of the United States, within the meaning of a particular statute. For the prevention of any such questions, it seems to me that the bill should contain a provision that, for the purposes of any statute of the United States requiring the payment of money into, or the deposit of money in, the Treasury of the United States, including acts of Congress appropriating moneys out of those in the Treasury of the United States, the Federal Reserve Banks shall be treated as a part of the Treasury of the United States.

I think the bill should contain, also, a provision giving a Federal Reserve Bank a first lien on all the assets of a bank holding stock in, and which may become insolvent, owing debts to such Federal Reserve Bank

The bill contains no provision exempting the property of a Federal Reserve Bank from Federal, State, or municipal taxation. I think it should contain such a provision.

I have carefully compared the provisions of the bill with the national bank act and the acts amendatory thereof, and I do not find anything in the latter acts that would require any changes in, or additions to the bill. The bill, in express terms, repeals considerable portions of the national bank laws, principally those relating to the deposit of government bonds to secure circulation, and to the formation of national currency associations. Other portions plainly inconsistent with its provisions, for example, Sec. 5131 of the Revised Statutes relating to the deposit of public moneys in national banks, it impliedly repeals. But the larger part of the bill consists of independent original matter, neither affected by the national banking laws, nor having any bearing upon the greater portion of those laws.

I enclose herewith a memorandum of changes that seem to me ought to be made in the text of the bill; and of queries as to parts of the bill that seem defective or obscure.

Respectfully,

(Signed) W. J. THOMPSON,
Solicitor.

(Enc.)

(Enclosure)

CHANGES AND QUERIES SUGGESTED BY THE SOLICITOR OF THE TREASURY, AFTER EXAMINATION OF THE GLASS CURRENCY BILL

SEC. 2

In line 6 of Sec. 2, after the word "Committee" insert the words "and to be known as 'Federal Reserve Cities'."

In line 7, strike out the words "the said" and insert the words "such Federal."

In line 8, strike out the words "designated by the Organization Committee hereinbefore established."

Add to the last line of the section (p. 4) the following words:

"and the sum of \$50,000, or so much thereof as may be necessary, is hereby appropriated out of any moneys in the Treasury not otherwise appropriated, for the payment of such expenses."

SEC. 3

This section provides, among other things, for the establishment of "branch offices" of the Federal Reserve Banks, but there is no provision anywhere in the bill as to what their functions shall be, or what officers or employes they shall have.

SEC 4

In line 3 of this section, strike out the words "and 5136" That section has nothing in it relating to the form of the certificate of incorporation of a national bank

The bill nowhere in terms provides a period of existence for a Federal Reserve Bank Sec 5136 Revised Statutes fixes the lifetime of a national bank at twenty years The bill provides in Sec 4, line 4, that a Federal Reserve Bank "shall become a body corporate and as such * * * shall have power to perform all those acts and to enjoy all those privileges and to exercise all those powers described in Section 5136, Revised Statutes"

If it was the intention of the bill to limit the lifetime of a Federal Reserve Bank to twenty years by this reference to Sec 5136, it is doubtful whether that purpose has been accomplished

There is no provision in this section, nor elsewhere in the bill, for the acquisition of real estate by the Federal Reserve Bank necessary for carrying on its business, or for the collection of debts due it

In line 16 of Sec 4, after the word "designated" insert the word "respectively"

In line 24 of Sec 4, after the words "chosen by" strike out the words "the Directors of" and insert the word "said"

SEC 6

In line 3 of Sec 6, after the word "balance" insert the words "of its value"

SEC 11

The last paragraph of this section provides that the compensation of the "President" of the Federal Reserve Commission shall be established in a by-law to be adopted by the Commission Section 12 provides that the Secretary of the Treasury shall be ex officio "chairman" of the Federal Reserve Commission Does this mean that the Secretary is to be President of the Federal Reserve Commission, and, if so, is he, under Sec 11, to receive additional compensation for serving in that capacity?

SEC 12

In line 17 of Sec. 12, change the word "Chairman" to "President," in order to conform to Sec 13 that the officers of the Federal Reserve Commission shall be appointed on the nomination of the President of the Commission

SEC 13

The provision of paragraph 4 of Sec 13 that the acts of the Secre-

tary of the Treasury shall be subject to the review of the Federal Reserve Board is obscure, in that it does not appear whether the acts of the Secretary to be reviewed are his acts as Chairman or President of the Federal Reserve Commission, or as Chairman of the Federal Reserve Board. And the provision that in case of his sickness his duties shall devolve on the Comptroller acting as "Vice Chairman" is obscure, in that it does not appear which body that he is to be Vice President of is intended—the Federal Reserve Commission or the Federal Reserve Board. In line 4 of paragraph 5 of Sec 13, the word "portion" should be "proportion."

SEC 22

In line 1 of Sec 22, strike out the words "banks depositing" and insert the words "banks holding stock"

SEC 23

The last part of this section is so drawn that the charging of interest on government deposits seems left to the discretion of the Federal Reserve Board. Should not there be a positive provision that the Federal Reserve Banks shall pay interest on such deposits?

SEC 25

Does not the power given the Federal Reserve Banks to reduce their circulation at their discretion, put it in the power of the banks to contract the currency of the country at will?

Paragraph 2 of this section provides for the redemption of its notes in gold. Should not the language of the provision be such as to indicate that there is to be a mere exchange of the notes for gold, with the privilege on the part of the banks to reissue the notes?

In line 1 on page 36, after the words "for exchange" insert the words "or collection"

SEC 28

In line 7 of Sec 28, should not the words "State" or "municipal" be inserted after the word "Federal"?

What is the object of the provision in this section that a national bank may continue to apply for and receive from the Comptroller circulating notes, but shall not be permitted to issue them? This should be cleared up.

This section provides for the substitution of 3 per cent bonds for 2 per cent bonds now deposited with the government to secure the circulating notes of national banks. Are the 3 per cent bonds so substituted to be held by the government to secure outstanding circulating bank notes until retired? If so, it should be so stated.

This section also authorizes the Federal Reserve Bank to receive from the Federal Reserve Board and issue at its own discretion a sum in notes equal to the par value of the 2 per cent bonds surrendered by a stockholding bank. Is it intended that the Federal Reserve Bank shall issue these Federal Reserve notes to the bank originally the owner of the 2 per cent bonds surrendered? If so, it should be so expressed. As the section stands, too much is left to construction.

SEC 32

In line 3, strike out the words "each quarter" and insert "in every three months."

SEC 33

This section provides for the creation of a contingent fund out of the earnings of a Federal Reserve Bank and for its disposition upon the "final dissolution" of the bank. Where and how is this final dissolution of the bank to take place?

And upon such final dissolution of the bank, what becomes of the 20 per cent surplus fund which has accumulated in its hands?

SEC 35

This section appears to be a reenactment of the first part of Sec. 5151 of the Revised Statutes, with additional new matter relating to the transfer of stock in the bank to avoid liability as a shareholder. If it was not the intention that the reenactment should supersede certain parts of Sec. 5151 not included in the reenactment, that fact should be made to appear.

SEC 40

What is the necessity for this provision? The existing law (Sec. 5211 Rev. Stats.) covers the same ground completely.

SEC 41

After the word "contract" in line 2, add "rights."

FURTHER CHANGES SUGGESTED BY TREASURY SOLICITOR
Department of Justice
Office of the Solicitor of the Treasury
Washington, D. C.

May 24, 1913.

Hon. W. G. McAdoo,
Secretary of the Treasury.
Dear Mr. Secretary:

I am in receipt of your note of the 23rd instant requesting copy of suggestions as to the Glass Bill before leaving for New York to-day.

On yesterday you handed me what you understood to be a draft of this bill differing from the one previously examined by me, but which I find upon examination is identical with the one previously examined. Hence there are but few additional suggestions to make in relation thereto to what have been previously made.

In section 3, strike out the word "outstanding," in line 2 between the words "the" and "capital."

In section 4, after the word "act," in line 9, insert the following: "The period of existence of a Federal Reserve Bank shall be the same as that prescribed by law for a national banking association, and such period may be extended in like manner as that of a national banking association."

In section 10, after the word "state," in line 3, insert the word "or."

When you have indicated your approval to the suggested changes made by me, or when you have indicated such changes as you may wish to have made in any of the provisions of this bill, I will be pleased to redraft the sections, enrolling such changes therein or amendments thereto as may meet your approval.

The papers submitted to me yesterday are herewith returned.

Very respectfully,

(Signed) W T THOMPSON

Solicitor

(Enc.)

APPENDIX C TO CHAPTER XI

The following was written to Chairman Glass by George M. Reynolds, then president of the Continental and Commercial National Bank of Chicago:

The New Willard

Pennsylvania Avenue, Fourteenth and F Streets

Washington, D C, 6/3, 1913

My dear Mr. Glass:

I am very sorry indeed I missed you last evening. When I came in about 10:30 P. M. I found your card and called you at once at the Raleigh but was informed you were not in. It being very warm I went out for a short ride to get "cooled off" and upon my return found your telephone call. I then called the Raleigh and was advised you had gone to the train.

Being unable to get any response to my phone calls to your office and failing to reach you at either your Committee Room or the Raleigh I assume you are out of town.

I must return to Chicago at 3 10 P M today, and regret very much I have not been able to see you

Seeing so many evidences of those in high places to scatter on the currency question, I feel a most vigorous effort should be made to have discussion of the matter centered upon your bill rather than some other which I regard as unsound in principle and incorrect in theory and it was with a view of doing what I can to assist in encouraging the passage of your bill that I desired to see you I would have said some things to you which I do not feel I can consistently write

I sincerely hope Prest Wilson is much more in sympathy with your bill than some others I have seen and heard of

In confidence I am

Very sincerely,
(Signed) GEO M REYNOLDS

CHAPTER XII

SENATORIAL OPPOSITION

Radicalism in the Senate and Cabinet

Although the center of radicalism in American political life had not prior to 1913 been generally regarded as being found in the United States Senate, it was undoubtedly to be sought in that body, so far as the banking question was concerned, in 1913. At the same time, as will be recalled, the radical Democracy had been fully recognized and had been given a strong foothold in the President's Cabinet by the appointment of Mr W J Bryan as Secretary of State. President Wilson's problem, therefore, as set forth in an earlier chapter, consisted in the first place of making his peace with the Senate radicals and at the same time of accomplishing a like result with the "left wing" of his own Cabinet.

What was chiefly to be feared was a junction between the disgruntled elements in both bodies which would have resulted in establishing an opposition to the administration that could not be successfully overcome. From the tactical standpoint, therefore, it was necessary for Mr Wilson to break up the various elements that stood opposed to him by working out a separate treaty of peace with each and inducing or compelling it to be either friendly or neutral. Already there were mutterings that were anything but reassuring, and rumor had it that an anti-banking entente was being established between the antagonistic elements in the Senate and Cabinet. At this point it should be said in justice to Mr Bryan that he proved to be entirely frank with the administration, and when the time came simply outlined plans for supporting the fed-

eral reserve proposal. They were, as will soon be seen, complied with, and as a result he gave wholehearted aid to the furtherance of the measure.

The Senate Situation

The case was somewhat different in the United States Senate. During the year 1912-1913, there had been an extensive reorganization of affairs in the Senate. The authority exerted by the old-line Republican managers, of whom Senator Aldrich was chief, had, as already seen, been severely shaken when the power passed from the autocratic hands of Mr Aldrich to those of a syndicate or group consisting of several of the secondary leaders in that body. The authority of even this group had for some time been on the wane, and with the opening of the Wilson administration the upper chamber had fallen into a condition of practical disorganization. During the autumn elections of 1912, enough changes had been made in Senate personnel to insure a small Democratic majority, so that it was certain that the special session which was called shortly after Mr Wilson took office would see a rearrangement of the committees upon a basis which would give the chairmanships and the majority control of each to members of the ruling party.

Organization of Senate

Without attempting to go into the details of the work done in reorganizing the Senate on Democratic lines, it may suffice for the present purpose to say that an effort was made to divide the chairmanships of the more important committees in such a way as to recognize, so far as possible, the different wings and conflicting interests within the party. At the same time, however, the reorganizers refrained from any serious violation of the principle of seniority under whose terms the senators who had been longest in service were regarded as having a vested right in the chairmanships of certain com-

mittees according to rank. To carry out this Bourbon idea, however, was found difficult because of the cliques and groups which had been formed within the party. Thus arose a demand for more chairmanships, and the idea was suggested that it would be well to divide the functions of some of the existing committees. In acting upon this proposal, the committee which most naturally presented itself for division was that on finance.

The Banking and Currency Committee

As has been seen, the Finance Committee had, under the Aldrich régime, gradually drawn to itself a variety of functions which in the House were diffused among a number of committees, and which, in few if any legislative bodies of the world, could be found in combination under a single hand. It had long been felt by careful observers that a crying need for reform existed in the Finance Committee and that its powers ought to be subdivided. A natural line of division was drawn between the function of dealing with measures on banking and currency and that which related to measures on finance in the proper sense—that is to say, taxation. After considerable legislative jockeying, into the details of which it is not necessary to go, a decision was therefore reached to create a new committee on banking and currency. At that time, however, few if any members of the Senate were aware of President Wilson's determination to press forward with banking and currency reform. The chairmanship and personnel of the Committee were consequently regarded as practically little more than pawns in the political game, since it was undoubtedly believed that the new organization would have only nominal functions for a good while to come.

It was intended at the outset to award the chairmanship of the Banking and Currency Committee to one of the old-line southern Democrats. Various difficulties, however, speedily presented themselves. Chief among these were the claims of

other senators who desired important places and who were able to set political machinery in motion for the purpose of satisfying their ambition. After a good deal of negotiation and adjustment, it was resolved to place at the head of the new Banking and Currency Committee Senator Robert L. Owen of Oklahoma, while the other members of the Committee included on the Democratic side Senators Atlee Pomerene of Ohio, Hitchcock of Nebraska, Reed of Missouri, Shafroth of Colorado, Hollis of New Hampshire, and O'Gorman of New York. On the Republican side were Senators Weeks of Massachusetts, Nelson of Minnesota, Crawford of South Dakota, and Joseph H. Bristow of Kansas.

Alignment of Members

The personnel of the Committee is worthy of careful analysis. On the Democratic side three distinct groups were to be recognized. The first consisted of what were then considered thick-and-thin administration men. These included Senators Owen, Hollis, and Pomerene. The second group consisted of the so-called "Bryan" Senators, prominent among whom was Senator Shafroth. A small group of anti-administration and anti-Bryan Democrats completed the classification, its chief members being Senators Reed and Hitchcock. Senator O'Gorman, who had originally been regarded as probably an administration Democrat, proved to be more nearly in sympathy with the opposition. On the Republican side of the Committee three groups were also to be recognized. The first consisted of old-line Republicans of the Taft variety, chief among whom was Senator Weeks, formerly a member of the National Monetary Commission. A second section of opinion was progressive Republican in its affiliations, being chiefly represented by Senator Bristow. Intermediate between these two wings was a group of liberal Republicans including Senators Nelson and Crawford. Thus the Committee was seriously split in its political affiliations, there being no less than

six distinct sections of opinion in a small body of only 13 members

Views of Senators

These differences in general political principle need not necessarily have affected the actual work of the Committee had its members been closely informed on banking questions. This, however, was unfortunately not the case. With the exception of Senator Weeks none had devoted serious study to banking prior to accepting membership on the Committee. Senator Owen was president of a small bank in Oklahoma but had had no genuine banking problems to meet in that connection. Some other members of the Committee had in the past indulged in general talk on problems of credit and money, but there was possibly none who would have professed to have an intimate knowledge of the situation. In fact, 'it is probable that few would, at the opening of the Wilson administration, have admitted a belief that they were likely to be summoned to participation in the framing of an important measure on the subject, although, as has been noted at a previous point, one or more members of the Committee had during the winter preceding the organization of that body, introduced bills dealing with the banking question. On the whole, the minds of the members were as nearly free of expert knowledge or technical information on banking and currency as could easily have been found within the Senate

Negotiations with the Chairman

Senator Owen, the newly made chairman of the Committee, was early called into consultation with President Wilson, Secretary McAdoo, and Chairman Glass. He was informed that a bill possessing the tentative assent of the administration had been drafted and was about ready for presentation. The information was not altogether acceptable to him. Not only did he seem to possess the preconceptions

against measures originating in the House of Representatives for which the Senate has been noted, but he was apparently determined to prepare a measure of his own which should form the basis of discussion and ultimately of possible action. Senator Owen, however, consented to examine with detailed care the bill which had been drafted in the House and did so.

The author was himself detailed to review the measure with him. On the 21st of May he had an all-day session with Senator Owen at his house in Washington and at that time every element in the House measure was carefully read and its implications discussed. Senator Owen did not on that occasion offer any very serious criticisms of the bill as drafted with two exceptions. He thought that the measure placed too much power in the hands of the banks and he contended that there ought to be no provision for the granting of credit by reserve banks on the strength of collateral security consisting of stocks and bonds. While he had of course some objections to details in addition to these two more important criticisms, his suggestions were not numerous. After closing the consideration of the bill on the date mentioned, Senator Owen used the following words: "I think well of the bill. It is a carefully framed measure." In answer to the expression of a doubt as to whether it could be passed at the current session, Senator Owen replied: "It can be passed. If I did not think so I should not be wasting time on it now."

Senator Owen, however, indicated that he had himself prepared a very much simpler measure "designed to attain the same objects as the Glass bill," and thought that it should have consideration while the subject was being studied. This bill, he said, would shortly be printed and he desired the author to make a careful analysis of it and report to him "with absolute frankness" any criticisms that might seem to be needed. In fact, a copy of the first draft of this "Owen bill" in printed official form, but designated "confidential" came into the author's hands within three days.

Senator Owen himself transmitted the bill to the author with the request that it be examined in detail and comment on it returned to him. Mr. Owen's letter fixes the date when his bill was made known, viz., just after the interview already described. (See page 230 for letter.) At about the same time the Owen bill was also handed to Chairman Glass, to Secretary McAdoo, and to the President. Requests for a memorandum analyzing the proposal thus put forward having been made, the following memorandum designed to cover the subject was prepared by the author and delivered to Chairman Glass by whom it was laid before the administration.¹

MEMORANDUM ON THE OWEN BILL

In the following memorandum attention will be paid to the provisions of the Owen banking bill both with reference to their own individual bearing, and as compared with the corresponding sections in a bill to be introduced in the House of Representatives and herein referred to as the Glass bill. The discussion will first deal with the Owen bill section by section, and will then present some general considerations. No attention will be paid to mere differences in the language of the two bills, although in shaping a final measure the terms used will be found to be of first-rate importance.

Section 1 This section deals with definitions and is not paralleled by anything in the Glass bill. It is probably a desirable feature and may well be included in any bill.

Section 2 Section two establishes reserve banks, designates their names and indicates the location of their head offices. These are to be eight in number. The Glass bill creates an organization committee to lay out districts and locate the banks which are to be not less than 15.

(a) As to designating the banks and districts I consider it unwise, because (1) existing data and statistics are not adequate to the performance of the work contemplated in laying out the districts. It would be necessary to get much information additional to what is now at hand, (2) if the banks are named and the districts laid out there will be conflict of opinion and friction with reference to the choice thus made.

¹ Mr. Glass on June 6, 1913, wrote the author as follows concerning the comment on the Owen bill: "I received the comment on the Owen bill which I will submit to the President at the earliest opportunity. I shall give Owen a printed copy of the Glass bill revised to date, but the new scheme (the McAdoo plan) so accords with Owen's expressed notions that I fear he will go off after it."

ROBERT L. OWEN CHAIRMAN
 ALBERT H. RICHMOND DEAN
 JAMES A. B. BROWN JR. Y JOSEPH L. WINTERMAN
 JAMES A. REED JR. ONE T. CROFTON O-BAN
 JULIE RICHMOND JR. GEORGE P. HILLMAN
 JOHN F. SHAFER JR. JOHN W. WELLS JR.
 HENRY F. WELLS JR.
 JAMES W. BELLER CLERK

UNITED STATES SENATE
 COMMITTEE ON BANKING AND CURRENCY

STRICTLY CONFIDENTIAL.

May 27, 1913.

Mr. Parker H. Willis,
 New York Journal of Commerce,
 New York City.

My dear Mr. Willis.

I enclose you the draft to which I referred
 and which I had printed for more convenient reference to page
 and lines.

I should greatly appreciate it if you would
 frankly criticise it, both as to omissions and commissions.

Yours very truly,

Encl.
 VWL

Paul H. Mc-

(b) As to the number, I think 8 is too small, but I believe that the number at the beginning is not fundamentally important. It is important to allow the formation of new banks and districts. I do not see that the Owen bill does this.

STATE BANKS AS STOCKHOLDERS

Section 3 Section 3 covers the same ground that is dealt with in the Glass bill under section 8. The purpose of the two sections is practically the same, so far as the first paragraph is concerned. In the latter part of section 3 of the Owen bill, it is provided that state banks may become stockholders in reserve banks under specified conditions. These conditions are practically the same as those prescribed in the Glass bill in section 9, but the Owen bill permits any state bank to become a stockholder, while the Glass bill leaves the decision as to such membership with the Federal Reserve Board (called in the Owen bill the National Currency Board). I do not think that it is wise to give the state banks the right of becoming stockholders unless first approved by a competent authority, because there are so many weak state banks whose business is such that they ought not to be admitted to membership even though their reserves are maintained at the same level as national banks.

Section 4 This section creates an organization committee along substantially the same lines as those prescribed in section 2 of the Glass bill. The Organization Committee is to lay out the country into districts notwithstanding that the location of the reserve banks has already been specified. I believe that this is unwise, for the reason that, as already stated above, the location of the banks and their number can not well be determined without more information, and the shifting of the districts' lines according to later information would necessarily mean the shifting of the head offices.

BOARDS OF DIRECTORS

Section 5 Section 5 organizes the reserve banks with boards of 9 members chosen six by the member banks voting by cumulative system and three by the President from a list furnished by the National Currency Board. The Glass bill creates three classes of directors, one chosen directly by the directorates of existing banks from their own number, one by the said directorates from outsiders and one by the Federal Reserve Board. The Owen bill calls for cumulative voting with one vote to each million of bank capital. With reference to this latter (Owen) plan, I note

(a) The system of voting would give the larger banks the control of the Board of Directors for each bank. For example, the National City Bank would have 25 votes as against one vote to a small bank of \$25,000 located in the country near New York. The cumulative voting provision would not necessarily cure the evil, because each unit of voting power is given as many votes as there are directors. For instance, in electing the board of directors in the New York bank there would be six to be chosen, while the National City would have 25 votes to each of the 6, or, if it chose, it might cast six times 25 or 150 votes for one man. Without having worked this out in detail (and it is impossible to work it out in detail until the districts are organized) I believe it would result in a bank directorate composed of six representatives of a very small number of large banks, with the three Government directors.

(b) The Owen bill does not provide for an active Government officer on the board while the Glass bill does. Such an officer is needed if the Federal Reserve Board or National Currency Board is to be effective.

Section 6 This section covers the same ground that is dealt with in the Glass bill in sections 11 and 12. Some of its minor features are dealt with in other sections of the Glass bill, but the chief proposition is the creation of a National Currency Board, consisting of three ex officio members taken from the administration and four Presidential appointees. The Glass bill creates a Federal Reserve Commission dominated by the banks and an executive board dominated by the Government, but with banking representatives thereon. I believe that the Owen bill is superior to the Glass bill in that the machinery of this central body is simpler*. I do not see any need for two bodies as now constituted in the Glass bill. They were inserted in their present form by the special request of the Secretary of the Treasury. As to the central board and its composition, I think the Owen bill is to be criticized in the following particulars:

(a) It gives no direct representation to the reserve banks. Yet these banks are certainly entitled to at least a minority representation inasmuch as the central board exercises the great banking powers of the country and practically has the ultimate welfare of each reserve bank in its hands.

(b) I think the description of the characteristics of the men who are to be designated will be injurious. What is wanted in the

* Since writing this comment, the Glass bill has been altered in the respect mentioned.

appointed members is banking ability, and not knowledge of transportation, commerce, etc

CAPITAL OF BANKS

Section 7 This section provides capital for the reserve banks and prescribes the methods of increasing and decreasing such capital. It follows substantially the lines in the Glass bill, sections 5 and 6, with some alterations, and I see no substantial or far-reaching objection to it.

Section 8 Section 8 deals with earnings of reserve banks and is practically parallel to section 7 of the Glass bill. There are some minor differences in respect to which I think the Glass bill is preferable, e g., in the creation of a fund to meet losses. The provision of the Owen bill exempting the reserve banks from taxation is not found in the Glass bill and is a good one.*

Section 9 The first paragraph of this section calls for the deposit of Government funds in reserve banks and is parallel with section 20 of the Glass bill. The objects aimed at in the two measures are substantially the same. Paragraph 2 of section 9 is very much the same as paragraph 3 of section 20 of the Glass bill. Paragraph 4 in section 9 is elsewhere provided in the Glass bill. Paragraph 5 prescribes the kinds of business to be done by the reserve banks and is similar to the provisions of the Glass bill in sections 16 and 17, 18, etc. These provisions are very similar in the two measures, although there are some detailed differences. Without stopping to analyze these at present, it may be stated that there is no fundamental or broad separation between the two measures in this regard, except that the Glass bill allows the reserve banks to go into the open market for the purchase of paper while the Owen bill apparently would not. I believe that the terms of the Owen bill in this section are not in all cases sufficiently specific and need much limitation and explanation.

CURRENCY BOARD

Section 10 In this section the powers of the National Currency Board are prescribed along substantially the same lines as in the Glass bill, in section 15. One broad power given in the Glass bill is withheld in the Owen bill. This is the power to regulate rates of discount at the reserve banks. This power should undoubtedly be granted the central board. Particularly is this true where the reserve banks are not allowed to go into the market for paper. Some of the reasons are as follows

* It is now incorporated in the latest draft of the Glass bill.

(a) The power to fix a minimum rate of discount enables the central board to regulate the extent of the discounts at each of the reserve banks with reference to others. It thus is able to keep a general control over the operations of such banks and prevent them from going too far or attracting to themselves too large share of the capital of the country. The use of the power to fix a minimum rate of this kind would be very essential if the power should be given to reserve banks to borrow from one another, as it would serve the purpose of preventing such banks from extending credits too largely in certain parts of the country, in order to foster boom or speculative conditions there. I do not think that there would be any danger in giving this power to a properly organized board with adequate sources of information at its disposal and full publicity for its acts.

(b) The power to fix a rate in this way is an essential part of the idea of central control and is so important a matter that it should be under strict Government supervision, as it is in other countries. If not specifically dealt with in this bill, it will presumably be exercised by the reserve banks at their own will. This means that the largest and strongest of them will undoubtedly be able to control or dominate. In other words, the condition of affairs will be very much the same as it is under the present system. If it is to be desired not to give this power to the central board for various reasons, then the various reserve banks should not be allowed to do business with one another freely, as they are permitted to do under the terms of the Owen bill. They should be carefully restrained in this regard, the ultimate control of their power to deal with one another being left in the hands of the central board. The Owen bill, however, gives no such power of control over inter-reserve-bank rediscounts, so far as can be noted, but leaves that matter to the banks themselves.

RESERVE CHANGES

Section 11 Section 11 is perhaps the most important section in the bill. In brief, it abolishes existing reserve requirements and substitutes a flat 15 per cent reserve for all banks, one-half at least to be kept as a balance in the reserve banks. By the terms of this section the whole of the reserve could, theoretically, be kept with the reserve banks, the individual banks simply keeping till money for current payment. Viewed from any standpoint, this plan would have two very serious results.

(a) It would stiffen the reserve requirements for the country banks. These now have to have 6 per cent in cash and 9 per cent with reserve

agents on which they get no interest. The Owen bill would cut them out of the interest, and, if they kept their balance with the reserve bank to the minimum—7½ per cent—they would have to add one-fourth more cash in their own vaults than they now do. If they established their balance with the reserve bank by rediscounting instead of by transferring cash, they would have to *pay* interest instead of earning it through interest payments made to them by other banks.

(b) It would lighten the reserve requirements in the cash of reserve city banks which now keep 12½ per cent in cash, since after the passage of this act they would only have to keep 7½ per cent in cash at most. It would greatly lighten the requirements in the case of central reserve city banks which now have to keep 25 per cent, since they would, under this plan, have to hold only 7½ per cent, at most, and might let their reserves run down almost to zero if they chose.

EFFECT OF ALTERATIONS

The various effects of the proposed reserve provision may be worked out somewhat as follows. The net deposits subject to reserve requirements on June 14th, 1912, according to the Comptroller's last annual report (page 266), were \$7,050,134,993. The reserve required (*ibid*) was \$1,423,474,516, of which \$875,598,548 had to be cash in the vaults. The sum then actually on hand, "due from reserve agents," and in the redemption fund was \$1,758,599,316, and of this the amount "due from reserve agents" was \$525,459,880, leaving \$1,233,139,436 of cash of all kinds. If, under the new plan, 15 per cent of \$7,050,134,993 were to be held in cash the sum needed would be \$1,057,520,248, or \$175,000,000 less than now held. Making the comparison on the basis of "reserve funds" actually held not on the basis of "cash," it is seen that the "total reserve held" on the date mentioned was \$1,505,459,880, of which \$525,459,880 was with reserve agents, leaving about \$980,000,000 in actual "reserve" cash. This would be about \$77,000,000 less than would be required under the new plan by the terms of our assumption. The former comparison, however, is the only fair one, because we are assuming that the transfer to the reserve banks is made in actual cash, and that no rediscounts are called for. If \$175,000,000 were set free by the new plan it would furnish a basis for about seven times that amount of loans on a 15 per cent basis, or a total loan expansion of about \$1,225,000,000. To this would be added the possible loan expansion of the reserve banks through rediscounts, with a 50 per cent reserve, equal to about \$1,057,000,000, or nearly \$2,300,000,000 in all. It is, however, impossible to suppose that the transfer to the reserve

banks would be made entirely in cash. The Owen bill requires that at least $7\frac{1}{2}$ per cent, or one-half the reserve, be placed with the reserve banks. This is clearly to be furnished by rediscounts obtained from the reserve banks. Were that done, the remaining cash in the vaults of the banks would be only $7\frac{1}{2}$ per cent of \$7,050,134.993. This is about \$451,000,000 less than the \$980,000,000 of "reserve" cash held by the banks on the date indicated. It is about \$704,000,000 less than the total cash they held. Even if "redemption funds" be omitted and the comparison be based solely on *specie and legal tenders* held on the date indicated, the new reserve requirement would be \$417,000,000 less than present *specie and legal tenders* held. Anywhere from \$417,000,000 to \$704,000,000 would, therefore, be released on this basis. It may be claimed that a deduction needs to be made from cash released because a rediscount with a reserve bank under the Owen bill requires a 50 per cent reserve. It is clear that under the foregoing supposition the banks would have to establish a credit of about \$528,000,000 with the reserve banks. Now, these banks would have at the start about, say, \$100,000,000 of capital (in money) and about, say, \$200,000,000 of Government deposits in money.

Supposing that they held \$100,000,000 to protect these public deposits they would still be easily able to furnish \$400,000,000 in rediscounts, and would have to draw in only about \$64,000,000 to make the rediscounts called for at the start. If it be argued that the capital of the banks—\$100,000,000—would have had to be drawn from the free supply of money, it will still be true that at least \$250,000,000 of cash would be set free by these operations. This, on a $7\frac{1}{2}$ per cent reserve basis, would be a possible loan expansion of \$3,000,000,000 at least. Nor is this all. Under the Owen bill there is no reason why a bank should not carry, theoretically, its whole reserve with the reserve bank and obtain it by rediscount credits. Were this to be done, it would in the last analysis mean a transfer of \$264,000,000 to the reserve banks, there to be used as a reserve against rediscounts of double that amount, or \$528,000,000, this latter sum being the $7\frac{1}{2}$ per cent reserve before assumed to be carried in cash in the vaults of the individual banks. This operation, if carried through, then would set free \$264,000,000 in addition to the \$250,000,000 previously released, or in all \$514,000,000 of cash. Somewhat the same result can be reached by taking \$945,000,000 as the *specie and legal tenders* held by the banks on the date named, deducting \$100,000,000 as the cash capital of the new reserve banks, leaving \$845,000,000, dividing this by two to ascertain the reserve needed by the reserve banks, which would be

\$422,500,000, thus showing a net release of equal amount, to which must be added \$100,000,000 of Government cash made available for banking purposes, or a total release of \$522,500,000 in all. Assuming that this sum were used by the banks as a $7\frac{1}{2}$ per cent reserve, the possible loan expansion would be about 12 times as great or perhaps \$6,250,000,000—rather more than doubling, therefore, \$5,953,000,000, the present volume of eligible bank paper. Other modes of estimating show even larger results. Long before this point had been reached in the process of expansion a serious panic, accompanied by gold exports, would have been induced. There are various ways of figuring this possible expansion—and this is the main point—but whatever plan may be followed will show an enormous increase in bank loans under this proposed system, undoubtedly running from two and a half to six billion dollars, according to circumstances. Moreover, as the reserve banks under the Owen bill have to keep a very large reserve (50 per cent) they would not be able to be of much assistance if the banks finally got into trouble through over-expansion of loans.

RESERVE BANK RESERVES

Section 12 This section deals with reserves of reserve banks, of which something has already been said, prescribing that there shall be 50 per cent gold behind the liabilities of every reserve bank. The Glass bill provides a reserve of 25 per cent behind deposits and 40 or 50 behind notes, according to the method of note issue. It seems, therefore, as if the Owen bill provided a stronger reserve. This is hardly the case, however. The Glass bill goes on to call for a secondary reserve of quick commercial paper. As a matter of fact, the amount of cash to be kept in the reserve banks will be regulated largely by the banks themselves, and the statutory requirements as to the amount are not fundamentally important, provided that sufficient flexibility is allowed. The Glass bill supplies this flexibility by its provisions as to the holding of a secondary reserve of commercial paper, while the Owen bill furnishes it by allowing the reserve to fall off subject to tax. The former method is the better. In the Glass bill, however, a provision has been made for suspending the reserve requirements subject to such a tax, but this is left in the hands of the Federal Reserve Board, as it ought to be, as such suspension should be managed through the ultimate central authority.

Section 13 This section provides practically the same plan of note issue that was worked out by Secretary McAdoo, and is found in both the Glass and Owen bills in a general form. The Owen bill leaves the

conditions as to the protection of the notes by commercial paper somewhat vague, and is open to criticism on that account. The Owen bill, moreover, provides for the charging of a minimum rate of 3 per cent per annum for the first four months upon the notes. Inasmuch as a reserve of 50 per cent has to be held behind the notes, this means that every dollar of flexibility in the currency costs the bank 6 per cent per annum. This, of course, makes the notes almost prohibitive in cost. I do not believe that the note section is satisfactorily worked out (a) because of its lack of fullness and preciseness, (b) because of the oppressive taxes it applies.

Section 14 This relates to examinations and parallels the examination sections of the Glass bill, except that the latter are longer and more detailed. The Owen bill calls for more reports from the reserve banks than does the Glass bill. This is a good point. An unwise feature of this section is found in the provision which allows directors of reserve banks to fix the payments to be made to national and state examiners. Such payment should be fixed by Government authority, preferably exercised through the reserve board.

GRAVE DOUBT AS TO BILL

In a general way, there are certain features of the Owen bill which must cause very grave doubt. These are as follows:

- (a) Practically unrestricted power on the part of the reserve banks to deal with one another and presumably to transfer their reserves to one another through the exercise of the deposit function.
- (b) Lack of Government control of any real type, inasmuch as the fundamental authority vested in the reserve board is inadequate, owing to the withholding of the power over the rate of discount and the power to regulate the regulations between the reserve banks.
- (c) Excessive reduction of reserve requirements to such an extent as to afford reasonable ground for fearing that the measure would lead to a serious inflation of bank loans with the resultant danger.
- (d) Defective regulation of reserve requirements.
- (e) Excessively costly note issues practically making the notes an emergency currency.

DEMAND FOR GOLD

At the present time it is well known there is a great demand for gold in Europe, and owing to the methods of banking pursued in the United States the strain will probably be shifted largely to this country and will effect a reduction of our great gold supply if we show the

slightest disposition to permit it. Under the Owen bill such a relaxation of the reserve requirements would occur as almost to insure the exportation of a large volume of gold. This would occur because of the great letting down in the requirements fundamentally, but it would also be likely to be furthered by the fact that the Owen bill does not describe minutely the terms upon which the change in reserve is to take place. It simply establishes a term of two years during which the change from the old to the new system will be effected practically at the discretion of the bank. During this time there might be a good many banks operating on one system of reserve and others on another. The most dangerous aspect of the case is seen in the fact that the reserve banks would have no control of the situation, because the inflation would occur before they had had much opportunity to check it through the use of the rediscount function.

In general terms, the Owen bill may be said to offer too many loopholes of danger, to be too vague and loose in its terms, and to play too largely into the hands of existing large banks. The difficulty under the present system does not lie with the country banks, but with the city banks, and yet the Owen bill makes large concessions to the city banks while it makes materially stiffer requirements of the country banks.

Views of Financiers

The memorandum in question called forth no comment from Senator Owen himself. He had, however, taken steps to get the views of various financiers on his bill. Besides being circulated among some members of Congress, copies of it were sent to New York and shortly appeared there in the hands of financiers. Some of these expressed decided satisfaction with the measure—in particular the president of one of the larger national banks who had been identified with the Aldrich bill movement praised it highly in conversation, saying, "It is simple and easy to understand. In about twenty minutes a man can master it. I believe this would be all right." This attitude in some aspects threw light upon the intimations that have since been expressed to the effect that the Owen bill (never before published until now) was in some way a measure designed to protect general popular interests the way that the

Glass bill did not. Other bankers who had received it, however, were less well pleased with the bill. Certain of them complained of what they termed the "loose language" of the measure and of the lack of harmony and vagueness of the expressions used in it. Samuel Untermeyer of 32 Wall Street, who as already seen, had taken a considerable interest in the early effort to develop a bill, described the measure as being correct in principle, although he admitted that there were many flaws which would need to be worked out. The bill was taken up for consideration at informal gatherings held at the Yonkers house of Mr. Untermeyer. At some of these Mr. Bryan was present. In Washington the measure was distributed to the members of the Banking and Currency Committee and other senators, while copies of it were placed in the hands of the President and Secretary McAdoo as representing what Senator Owen was prepared to urge upon his Committee.

President's Problem

At the middle of May President Wilson had before him three distinct plans of banking and currency reform: (1) the Glass bill drafted as already described, (2) the Owen bill shaped by Senator Owen and his advisers as just indicated, and (3) the McAdoo plan (already reviewed in a former chapter), which was not in bill form but constituted the basis for proposed legislation. It will be observed that none of these bills had become generally or widely known either in Congress or outside of it. The Glass bill had become known in outline only to a few bankers and others who had made special inquiries concerning it. The McAdoo plan had been distributed to selected bankers with a view to getting their indorsement, which, however, had not been forthcoming. The Owen plan had likewise been distributed and had been given a limited support, by a small group of bankers. Although efforts were made by Secretary McAdoo and Senator Owen

to focus upon the President such support as they could get in favor of their respective plans, nothing had been done by Chairman Glass in this direction until he began to fear the possibility that the McAdoo plan might gain ground with the bankers, when, as has been seen, he obtained criticisms regarding it from a limited number of well-known financiers. But essentially, it was necessary for the President to make his own choice, particularly as Colonel House was no longer within reach, he having sailed for Europe. It had required about three weeks for President Wilson to reach a definite conclusion as to his course of action. During that time but little was heard from him, save for an occasional question or a brief conference with some of those who were responsible for the preparation of the new measure. But when towards the beginning of June he finally announced to Chairman Glass his intention to discard the McAdoo plan and to support the Glass bill, making it an administration measure, the decision implied that the project of Senator Owen must also be discarded. The memoranda and analyses submitted to him, and the positive information that the Owen bill was out of the question, convinced him and he issued the needful orders. Senator Owen, although far from pleased, finally expressed a willingness to "work over" the terms of the Glass measure with a view to introduction.

An Identical Bill

The President expressed to him a desire that the bill should be introduced simultaneously in the House and Senate and that it should be understood that in both chambers it represented the views of the administration. This of course made it necessary to obtain the unequivocal assent of Mr. Owen to the measure as it then stood. In view of the fact that the President had expressed a disinclination to have the bill altered in any essential particular, Senator Owen's field for possible changes originating in the Senate, prior to the introduction

of the bill, seemed to be exceedingly small. At a series of conferences which occurred during the week ending June 10 Senator Owen sought to secure such alterations as he could within the narrow limits thus granted. In particular he undertook to show that the reserve provisions of the bill were unreasonably drastic, and that if applied as they stood they would "result in drawing into the new banks all the money of the country" and perhaps more. He further objected to a variety of minor points contained in the draft as it then stood. In answer to the criticism on the reserve provisions, it was comparatively easy to show that no such consequences as he expected would follow the operation of the reserve section. Nothing whatever was advanced to show that the reserve section would require more money than was needed to meet existing banking law demand, but rather the contrary, since it appeared plainly that the act would in operation tend to relax the reserve requirements to a limited extent, thereby probably freeing a considerable amount of reserve money, should the bankers be willing to take advantage of the privilege of rediscounting from the very outset. The close of the conferences therefore left Senator Owen practically unable to effect any modifications of even secondary importance in the text of the measure.² It was agreed on Monday, June 12, that the proposed bill should be submitted to the President on the following day and that it should be held in strict confidence until such time as the introduction of the measure was authorized,

² Mr. Glass wrote on June 9

"Owen today manifested every disposition to be conciliatory and to come largely to the terms and details of my bill. He unhesitatingly avows his enthusiastic indorsement of McAdoo's scheme, but when I told him that I was almost unalterably opposed to it and believed it would create a political revulsion in this country, he greatly modified his position and said, that being true, he would not be willing to follow the Secretary. He spoke of the forthcoming meeting of the currency commission of the American Bankers' Association and said he apprehended that the action taken there would correctly reflect the business sentiment of the country. It is, therefore, important that there should be no mincing of matters when the currency commission meets. If it will approve our bill in a straightforward way I am sure we shall be able to accomplish something. If you do not mind, I would be glad if you would read this paragraph of this letter to our friend Mr. Hepburn.

"I have an appointment with McAdoo at five o'clock this afternoon, when I shall expect to learn whether he proposes to persist in his advocacy of this new scheme. I have reason to think that there will be a halt in this direction."

a step which, it was supposed, would probably be taken immediately. This expectation, however, was not precisely fulfilled, owing to difficulties which arose out of the relationship between the President on the one hand and Mr. Bryan on the other. These must be reviewed at some length in the next chapter.

CHAPTER XIII

PLACATING THE RADICALS

The Bryan Influence

Although it had been possible to effect a working arrangement with Senator Owen, largely by the expedient of merely laying down the law, the President stating his views as to the introduction of a bill in identical form in both House and Senate, this method had its own elements of difficulty. In the last chapter it has been seen that there had already been indications of a junction between the Bryan element in the Congress and in the Cabinet. Senator Owen's agreement to introduce the Glass bill in the Senate and to lay aside the plan which he himself had framed on the Glass model was a technical step toward success, but still left open enormous possibilities of future difficulties. It was recognized from the outset that, even though the Glass bill should be given a nominal start in the Senate, there would be an immense field of possible trouble in the Senate Banking and Currency Committee, which contained some convinced Bryan men as well as a group of general radicals who were likely to be opposed to practically anything that might be suggested. More than mere toleration for the measure was accordingly necessary, and President Wilson recognized from the beginning that it would be essential to have the bona fide sincere support of Mr. Bryan. The question whether this could be had was another matter. Having for the moment turned the flank of the opposition by securing Senator Owen's agreement to introduce the measure in the Senate, the President now had to undertake the much harder task of seeing to the support of it.

Cabinet Situation

In order to get a thorough understanding of the situation existing at about the beginning of June, 1913, it is necessary to review very briefly the relations which had been established with Secretary Bryan during the first three months of the Wilson administration. Mr Bryan had been a member of the original Cabinet which took office on March 4, and from the beginning of his membership in the Wilson administration had been very desirous of knowing the direction to be taken by banking legislation. Indeed, Mr Bryan had hardly taken office before he began to inquire about the rumors which he had heard concerning the President's attitude on banking, as well as the situation which was supposed to exist in the Banking and Currency Committee of the House. The President referred his Secretary of State to the Treasury Department and Mr Bryan's inquiries became so numerous and specific that they were described by the Secretary of the Treasury in conversation as "very embarrassing." This embarrassment was probably greater on account of the fact that the Secretary of the Treasury himself did not at the time have more than a very general knowledge of what was being done.

Secretary Bryan had been feeling greater and greater anxiety regarding the prospects of the new measure and a small group of members in the House of Representatives had been goading him to take action against the plan which was being shaped with the approval of the President under the direction of Chairman Glass. At some conversations which he had held with Treasury officers and with members of Congress favorable to the bill, he had been assured that there was nothing that would give him ground for anxiety or reason for opposition, and he was urged to wait patiently until the final completion of the measure. The preparation of the final draft and the fact that all was now presumably ready gave Mr Bryan opportunity for demanding further information.

As has been seen, the negotiations during March and April

with reference to the currency situation did not result in any general distribution of copies of the proposed bill, so that Mr Bryan was unable to obtain more than extremely vague and scanty descriptions of its contents. It was, therefore, necessary for him to confine his discussion of it largely to generalities and hypotheses. Those who opposed the bill in Congress had counted very largely upon the assistance of Mr Bryan in the belief that the proposed measure would be what was then technically called "conservative," so that Mr Bryan could be counted upon to assist in defeating it. This danger was very early perceived by the friends of the bill, but they did not succeed in obtaining from Mr Bryan anything more than vague expressions of desire to see something satisfactory and useful enacted. As soon, however, as the first print of the Glass bill in confidential form was made immediately after President Wilson had reached his decision to support the measure and had so notified Secretary McAdoo and Senator Owen, copies of the completed measure were at once given, as they necessarily had to be, to Senator Owen, the plan being that he, if willing to do so, should introduce the measure in the Senate simultaneously with similar action in the House on the part of Mr Glass as well as other members of the Senate Committee. It is probable that only a few hours elapsed between the handing of the printed bill to Senator Owen and the time when it came into the possession of Mr Bryan. Such at least is the testimony of some of those who were in close touch with the situation. Hardly had copies of the revised draft been struck off from the press when members of the Senate Banking Committee who were closely in Mr. Bryan's confidence hastened to him with the confidential draft and undertook an analysis of its terms. Mr. Bryan and these advisers immediately hit upon two points of serious criticism: (1) the fact that bankers were permitted to elect representatives who should have seats upon the Federal Reserve Board, and (2) the arrangements made for the refunding of the out-

standing 2 per cent bonds and the retirement of the national bank notes based thereon. What had been done with reference to the note issue was partially satisfactory, but on the points mentioned the definite opinion was reached that changes must be obtained. This opinion was speedily conveyed to the President.*

A Bryan Ultimatum

M₁ Bryan after a careful study of the terms of the measure expressed willingness to accept the general outline and plan of the bill, but desired that the following changes be definitely introduced into it

- 1 Revision of the section on notes so that they should appear to be government notes or Treasury notes, guaranteed by the government, issued by the government, and payable to the government—in other words, a government currency
- 2 Revision of the sections relating to the organization of the Federal Reserve Board or controlling body of the system so that it should be a purely governmental body selected by the President and confirmed by the Senate
- 3 Modification of the sections relating to public deposits in such a way as to insure full government control over public funds at all times.

This proposal was the second serious problem with which the framers of the bill had had to contend in a political way, the first being the effort to substitute the McAdoo-Williams scheme with its proposal for a government-operated system of sub-treasury banking. It was recognized that it was undoubtedly necessary to meet the Bryan proposal frankly and squarely. To ignore it would have meant to encounter an opposition in Congress which could practically not have been overcome and would almost certainly have insured the defeat of any measure against which it was directed. The question therefore became essentially this—how can the requirements of Mr. Bryan and

his section of the Democratic party be met without essentially destroying the purposes of the Federal Reserve Act? On this point the most urgent and critical question was evidently that relating to the note issue, and this was the first to be taken in hand

Shift in Note Issue

In its original form the bill had intended to provide for the issue of bank notes by federal reserve banks, such notes to be in no respect different from ordinary bank currency, but representing simply the liability of the bank. As such they would of course have possessed an unusual credit, due to the peculiar standing of federal banks as the representatives of the combined strength of many banks, but they would have had no public or governmental quality. It had been a tradition in the Democratic party for many years that there was something objectionable in the issue of such bank notes. The philosophy of the party on this point ran about as follows: The issue of notes is a function of the government and their value and circulating power are largely due to the fact that they are issued with a governmental stamp. There is also a large profit to be gained from the circulation of money or its substitutes and this profit should inure to the government under whose auspices such money is circulated. Paper currency should therefore never be issued without some arrangement whereby a substantial part or the whole of the profits derived from it should be taken by the government. True, Democratic politicians had always complained of the so-called "double profit" supposedly derived by the banks from the fact that they drew interest on the bonds which they deposited in trust and at the same time obtained interest on the loans of notes which they arranged with their customers. As applied to the federal reserve notes, the argument against their issue purely as bank notes was materially weakened by the fact that the law provided for the payment to the government of all

profits by the banks over and above 6 per cent of capital stock. Nevertheless it remained true that Mr. Bryan and his associates in the silver wing of the Democratic party were indisposed to recognize a power vested in governmentally chartered institutions of issuing what was called "asset currency." Hence the Bryan proposal practically amounted to a request that the new notes should be issued by the government instead of by the banks, the banks being merely the instrumentalities through which they were to be paid out. It was of course true that provision had been made for the custodianship of "collateral" to be held behind federal reserve notes by a governmentally appointed officer known as a "federal reserve agent," but under the provision of the original bill it would still have been the case that the notes would not have been liabilities of the government and would not have been necessarily subject to control in the conditions of this issue. Practically applied, therefore, as a proposed amendment to the new bill, Mr. Bryan's ideas might be sketched as follows:

- 1 That the new notes should confessedly make their appearance as Treasury notes to be obligations of the government
- 2 That such notes should be issued only upon application to the government or to a governmentally appointed body.
- 3 That redemption of these notes should be provided for in Washington through the agencies of the government

An examination of these elements of note issue showed that none of them was necessarily inconsistent with the mechanism or working of the Federal Reserve Act. The question at issue was largely one of theory, since discussion developed that there was little or no disposition to disturb or change in any material respect the mechanism for note issue which had been provided in the existing draft of the Federal Reserve Act, and since the question of making the notes government obligations would not necessarily change the conditions under

which they were to be issued. It was of course undesirable as always to add to the volume of government obligations outstanding or to have in existence notes whose real nature was that of a bank note but whose technical character was that of a government issue. Full discussion therefore resulted in an agreement to make these changes, if by so doing the support of the Bryan element in Congress could be secured.

Composition of Board

As to the other question—the composition of the controlling or central body—the case was more difficult. In the original draft of the bill, as has been noted at another point, it had been intended to vest the real management of the federal reserve system in the hands of an executive committee representing the Board, consisting primarily of bankers. This executive committee was intended to contain a sufficient amount of government representation to insure freedom from undue control or influence on the part of the banking community, but it was intended to be genuinely representative of the bankers of the country and to constitute in the best sense of the term a “banking board.” The idea of turning it into a government body of the conventional type constituted a distinct innovation in the proposed make-up of the system and one which it was believed would undoubtedly alter in no small degree the attitude of the banking community toward the measure. It was therefore felt that the proposed change ought not to be introduced except as a matter of the utmost urgency from a political standpoint. President Wilson had, however, been convinced by Mr. Bryan and his associates that a change in the composition of the proposed Board, whereby it would become an active government body, was essential, and he resolved to secure the modification of the measure accordingly. The outcome cannot be better stated than in the language of a letter written by Mr. Glass within a few minutes after the White House interview at which the proposed amendments

were practically ordered incorporated in the pending measure Mr Glass wrote the author as follows

Tonight I had a three hour sitting at the White House, the result being that the President wants the bond refunding cut out of the bill He knew of no particular opposition but feared a fight on this provision might develop I told him I believed that feature strengthened the bill but I would offer no serious objection to its elimination

He then proposed to eliminate all banking representation from the Federal Reserve Board To this I urgently objected He would have the President directly name four members of this board, together with the ex-officio members, making it an entirely government affair I pointed out the injustice to the banks involved in this idea, and McAdoo upheld me for a while I also told the President his proposition would put the whole scheme into politics and that he could not expect a powerful Republican minority in the Senate to sit quietly by and permit the creation of a banking system, the absolute control of which, to begin with, would be in the hands of men all appointed by a Democratic President I said to him I considered the proposal both inexpedient and fundamentally wrong, but Owen promptly agreed to it and McAdoo yielded also *It is wrong, totally wrong*, in my judgment and they will find it out pretty soon

On getting back here at midnight I found Bulkley waiting for me He stayed till one A M and declared his purpose to protest to the President tomorrow against the proposed changes I shall continue to object These two changes are also proposed

Mr. Glass's View

It is thus seen that Mr Glass had with great reluctance accepted on behalf of the Committee the change whereby the composition of the Federal Reserve Board was materially altered It is proper to add at this point that the change in the composition of the Federal Reserve Board, although regretfully accepted by Mr Glass, was subsequently heartily approved by him and that in several public addresses he later testified to his change of view, expressing in unequivocal lan-

guage the belief that the original proposal had not been wise¹ Whether wise or unwise the plan first put forward was at all events abandoned, and in its place there now appeared a provision calling for the appointment of a Board of seven members, two of whom should be the Secretary of the Treasury and the Comptroller of the Currency, while five should be appointed by the President of the United States by and with the advice and consent of the Senate Some time was required in securing the complete alteration of the section relating to the note issues and that relating to the composition of the Federal Reserve Board, and in securing the incorporation of some minor changes that had been agreed upon The bill, however, made its appearance in final amended form on June 23, and as thus reconstructed met the approval of Mr Bryan, who fulfilled his part of the undertaking relating to the bill by issuing to the press a statement heartily indorsing the measure in practically every particular This statement became public on June 25, 1913 The *Philadelphia Public Ledger*, on June 26, published the following article:

SECRETARY OF STATE BRYAN ON THE CURRENCY BILL

Specially Written for the *Public Ledger*

The Currency Bill, prepared by Chairman Owen, of the Senate, and Chairman Glass, of the House, in conjunction with President

¹ The change in the note issue whereby the original provision for bank notes was converted into provision for an issue of Treasury notes was deeply regretted by all who were familiar with the banking and monetary history of the United States And yet it was made in such a form as to be perhaps least obnoxious When it became evident that this concession at least must be made to Mr Bryan, Mr Glass sought an interview with President Wilson and represented to the latter the arguments against the adoption of the alteration His argument availed nothing, the President pointing out that in the discussion it had been agreed that the new notes should be issued only at the instance of the reserve bank, should get into circulation only through the natural method of issue to customers who presented eligible paper for discount and should be retired through the retention of the elaborate provisions designed to guarantee elasticity which were embodied in the law The fact that the new notes were to be made obligations of the United States receivable by the government and thus technically a government currency and the further fact that they were to be issued only at the consent of the Treasury authorities, were by him regarded as unessential elements which might well be waived if in so waiving them it was feasible to obtain important concessions from opponents who might otherwise destroy the whole legislation There was force in this argument and Chairman Glass became entirely converted to the course demanded by President Wilson, giving his assent to the modifications made although never probably approving them in his own mind save as a means of obtaining actual progress

Wilson and Secretary McAdoo, is now before the country for discussion

It is known as the President's bill, because his influence was paramount in reconciling the difference existing between those favoring currency legislation

The President, in his message to Congress, urged immediate action and was felicitous in the language employed. He pointed out the need of legislation which will enable the business world to make use of its securities in times of emergency. While he did not outline a measure, his message should be interpreted in the light of the bill which has already been given to the Public.

The first question to be considered is whether there should be immediate legislation. It would be hard to answer the question in the negative, in view of the fact that the need for currency legislation has been emphasized in every quarter and by all who have cared to express themselves on the subject.

This objection, however, can hardly be made when it is remembered that resort has been had to nearly every form of investigation during the last few years, so that it may be assumed that every one who desires to form an opinion has had an opportunity to do so.

As a matter of fact, the fundamental principles involved in currency legislation are so well understood that the delay, however extended, and no investigation, however thorough, would be likely to change the minds of those whose duty it is to act upon the matter.

A request for delay may, therefore, be regarded as a motion for continuance, made by those who object to the principles upon which the bill is drawn, and a demand for further investigation can fairly be considered in the same way. So true is this, that it is quite certain that those who now favor delay would, in all probability, have been the very ones to urge speedy action if the bill had been differently drawn.

When the bill is considered upon its merits, one at once realizes that it is written from the standpoint of the people rather than from the standpoint of the financiers. The latter are quite unanimous in the belief that the issue of money is "a function of the banks" and that "the Government ought not to go into the banking business."

The Democratic party, however, has consistently taken the position that the issue of money is "a function of the Government" and should not be delegated to banks. It all depends upon the point of view from which one considers this question, or, for that matter, any public question.

President Wilson, in his letter of acceptance and in his speeches, reiterated his determination to look at all questions from the standpoint of the people rather than from the standpoint of a privileged few. This was the central theme of his addresses, and he cannot well depart from this position in the framing of a currency law, especially since the Democratic Party has never deviated from this position in its platforms.

If currency reform is to come under a Democratic President, a Democratic Senate and a Democratic House, it must come along lines in harmony with Democratic history and doctrine.

This bill involves three fundamental principles.

FIRST The notes issued must be issued by the Government and not by the banks.

SECOND The issue must be controlled by public servants and not by private institutions or individuals.

THIRD The emergency currency issued must be issued through State banks as well as through national banks.

This bill as prepared observes these three requirements. The right of the Government to issue money is not surrendered to the banks; the control over the money so issued is not relinquished by the Government, and national banks are not given a monopoly of the benefits flowing from the issue of these emergency notes.

The people, having safeguarded their rights in the three particulars above mentioned, can afford to deal liberally with the remaining provisions of the bill. The regional reserve banks will prove of great advantage to business. Each reserve bank will be a commercial center and this center will be much nearer to the extremes than the few large cities are to the banks which have been compelled to reach the public through them.

These national reserve banks will give to the individual banks a security for their reserves that is lacking under the present system—a security which will go far toward preventing panics.

The national banks, however much they may be inclined to object to the extension to State banks to the right to borrow emergency treasury notes, will find this bill so advantageous as to make them willing to accept its provisions. The right to borrow treasury notes on an equitable basis, without having to put up bonds, is a distinct benefit, and yet a benefit which can be granted with advantages to the community represented as well as with safety to the Government.

When a bank is compelled to put up bonds as a security it has

already parted with as much money as it can possibly borrow upon them. Hence a bond basis reduces to a minimum the advantages to be derived from borrowing.

Why should the Government require bonds as security for the loans to be made when the other security provided for is adequate? The Government can have no interest in prescribing onerous conditions to the banking world. The regional reserve bank, representing as it does the banks of its district, would be financially good for the money borrowed even if it was not required to put up specific security, but its security is made greater by the fact that collateral will be put up to secure each loan.

It is possible, under this plan, to provide immediate relief to any section of the country, and thus cure in the very beginning a condition which, if allowed to continue, might precipitate a panic.

It is not contended that the bill is perfect in detail. No one, or even a few, can hope to draft any measure upon any important subject which will in every detail be satisfactory to the 500 Senators and Representatives who must pass upon it. Whatever defects it may have will be brought out by discussion and cured by amendment.

But, considering the principles involved, who can afford to oppose so wise a measure as that now offered? Not the general public, because their rights are fully protected. Not the business interests, for their needs are fully met. Not the State banks, for they come, for the first time, into association with the national banks in the enjoyment of accommodations furnished by the Government. Not the average national bank, because the President's plan is to it a life preserver. Who, then, can object?

Only two classes. Those who dispute the right of the people to issue through their Government the money which the people need, and those who, distrusting the representatives chosen by the people to guard the public welfare, would deny the Government Officials control over the issuance of emergency notes.

(Signed) W J BRYAN

Washington, June 24, 1913

Effect of Bryan Concessions

In view of the constant statements which have made their appearance on many occasions in the past few years, and which are still heard at intervals, to the effect that the Federal Reserve Act was in some way "drafted" by Mr Bryan or his

associates, it is worth while to devote some consideration to the exact effect produced by the changes which have just been outlined. The effort has been made at earlier points in this volume to appraise as accurately as possible the contribution made by different elements in the various political groups and in the outside community to the make-up of the Federal Reserve Act and to assign to each as truthfully as may be its due responsibility. Justice requires a non-partisan effort of the same kind with respect to the work done by Mr. Bryan in this connection.

Undoubtedly a place of first rank must be assigned to the change which was made in the Federal Reserve Act whereby the management of the system was shifted from the hands of a body largely composed of bankers acting in at least an influential advisory capacity to those of a body composed only of government appointees. Later experience was to show that many of the troubles of the reserve system grew out of this change. What these were will appear in later chapters, but at this point it is proper to anticipate sufficiently to say that the dangers of political influence which were expressed in many quarters when the make-up of the Federal Reserve Board became known were never warranted in the sense in which their authors intended them, but were amply warranted in a broader and more serious sense as experience regrettably made plain. In a certain broad sense, therefore, it may quite frankly be conceded that the effect of Mr. Bryan's interposition was to make the change from a business to a political control of the federal reserve system. When this change is attributed to Mr. Bryan it should be definitely understood that what is meant is that element in the Democratic party of which Mr. Bryan was the recognized head. Undoubtedly the change thus made was made with his full approbation and at his demand. But even had he been opposed to it, it would seem highly probable that this change would have been forced before the bill had gone far. Some concession to the Bryan

element in Congress and in the nation was undoubtedly unavoidable. Even had Mr. Bryan's own judgment commended to him the original plan of the bill, it would have been necessary for him to recognize the feelings of his followers, and if he expected to remain at their head to make this concession to them. On the other hand it may well be questioned whether the original plan of the Federal Reserve Act would have operated any better. In drafting the original provision the greatest doubt had been felt as to the wisdom of it. Many changes in it had been made during the early stages of the measure and at one time consideration was given to the proposal, later to figure prominently in the discussion of federal reserve affairs, that the federal reserve banks themselves be given the power of selecting individuals from their own districts who should together make up the Federal Reserve Board, perhaps with an added element of members drawn from public life.

Bankers' Responsibility

It is probable that this plan or something like it might have been retained in the bill had not the attitude of the bankers made it perfectly evident that they would submit neither to the holding of stock in the reserve bank by private individuals nor to the acceptance of deposits from individuals nor to the making of direct discounts for such individuals. If the reserve banks were to be in a large sense "bankers' banks"—operated by bankers for bankers and under banking auspices—it might well be questioned whether the additional step of giving to the bankers complete powers of self-management was wise. It would have cut the government quite effectually out of any direct control over the affairs of the reserve system, and since the public was already effectually excluded through the refusal to do business with it, the effect of such legislation would have been to strengthen in very large measure the hands of an interest in the community which would thus have been given

that basis for monopoly power which it was believed by many to possess already. All in all, therefore, it may be a very fair question whether the change insisted upon by Mr. Bryan was not a necessary offset to the highly narrow and specialized character which had been bestowed upon the reserve banks as the result of the necessities of the banking situation itself.

And yet it cannot be denied that the change thus introduced was a change in one of the main features of the system and that to that extent an important participation had been granted to Mr. Bryan and the so-called radical element of the party. It was much more than a "sop" to radicalism that had been granted—it was a recognition of a certain element in the radical program, fixed as this was upon the theory of government control of business. It was a yielding of the classical doctrine of *laissez faire* in banking in favor of the idea of public participation and direction. The change made was certain to breed trouble and speedily did so but whether that trouble was greater than would have come from a retention of the original program may well be questioned.

Public Indifference

Although at the time a certain amount of discussion was centered upon the composition of the Federal Reserve Board, the fact that it had been altered as a result of Bryan demands was not very widely recognized and the composition of the Board really received much less notice than it was entitled to, as well as much less than was given to the subject of note issues. On the latter point very considerable debate immediately developed. Democrats apparently were completely satisfied by the fact that the notes of the new system were to be obtained only from the Treasury, could be refused by the Board, were government obligations, and in everything but name possessed the quality of legal tender. It was, as one New England senator remarked in conversation, "a necessary concession to past precedent, very pleasing to the Democratic

party" Perhaps this judgment was well founded but in any case the change in the note issue thus introduced was of no immediate importance whatever Since the bill retained the safeguards surrounding the issue and protection of the notes and the establishment of reserves against them which had been originally provided there was no reason to fear overissues or unsoundness From the immediate standpoint the judgment of President Wilson coinciding with that of Henry IV to the effect that "Paris is well worth a mass," was amply justified He had given the radicals what appeared to be the exterior shell of currency inflation while retaining beneath it the sound interior which would prevent decay

Control of Boards of Directors

At one other point changes occurred as a result of the Bryan influence which as matters turned out were of no importance but which deserve attention It had been originally planned to give the government representation on the boards of directors of the federal reserve banks, but this provision now became a definite authorization for the appointment of three such directors (one-third of all) with the explicit stipulation that one to be named as federal reserve agent should also be chairman of the board of directors This provision was one which gave no little anxiety to bankers for a little time, since they feared that the chairman of the board was intended to be, or would by some expedient be made, the operating head of the bank to which he was named This was never the intention nor did it develop as the fact, and while it was not deemed expedient in the bill itself to specify in detail the organization of the reserve banks themselves, this being left within the power of the Federal Reserve Board, it was always expected that each such bank would name a practical banker as the executive operating head of the institution This indeed the Board indicated to the reserve banks soon after their establishment How this intent eventually became distorted and

what were the results of this one-sided development which occurred at a later date need not concern us here. It is enough that there was nothing in the bill which necessitated the giving to the chairman of the board of directors more than a suitable status as representative of the government in the particular bank to which he was accredited.

As for public deposits, the third item which had aroused criticism, it was hard to say whether the objection came most sharply from the Bryan element or from the McAdoo-Treasury group. Neither was willing to transfer the full management of public funds to reserve banks. Changes accordingly were introduced with the purpose of making the use of the reserve banks as depositaries and fiscal agents optional rather than compulsory so far as the Treasury was concerned and it was agreed that the Department should have the privilege of later and more extensive remodeling—a privilege of which it amply availed itself before the legislative consideration of the measure was over.

CHAPTER XIV

CONSOLIDATING THE PARTY

Early Legislative Autocracy

It will be recalled that in the House of Representatives the downfall of the autocracy which had been controlled by former Speaker Cannon had been followed by the establishment of a so-called "democratic" type of control in which Democrats and Progressives joined. It will also be recalled that when the control of Congress passed definitely into the hands of the Democratic party in 1911 those Progressives who had shown a tendency to "work with the Democrats" found themselves eliminated from the councils of that party, while a new plan of legislative control was set up through the simple expedient of vesting in the Ways and Means Committee nearly all the powers formerly held by the Speaker. The type of legislative control which had thus succeeded the older autocratic management did not prove to be very much more liberal than the Cannon system. Indeed, what was really equivalent to a steering committee soon developed itself, and at the opening of the new Congress in the year 1913, this steering committee took in hand the question of a program for the session in very much the same way that had been followed by the old-line or Bourbon Republicans of the Cannon period. The program as thus formulated in a preliminary way included two elements—the enactment of legislation on the tariff and the suspension of action on all other subjects, it being agreed that in order to prevent any "misfires" in legislation no committees should be appointed except the Ways and Means Committee. It would

seem that the agreement which had been arrived at in this way was intended to check action on banking quite as much as, if not more than, on any other subject.

Fear of Banking Plans

As has been seen in earlier chapters, both parties had become morbidly afraid of banking plans and proposals, and the party leaders still did not trust Mr Glass, who, under the seniority rule, should have become chairman of the Banking and Currency Committee when organized. Indeed, some of those closely in the confidence of the ruling clique in the House of Representatives went so far as to say that so long as Mr Glass was prospectively the chairman of the new Committee they would not consent to the organization of the Banking and Currency Committee, since such action would bring a probability of early action respecting a reform bill. As the new session grew older it became clear that no banking committee would be appointed in the House of Representatives unless banking reform was made an integral part of the program of the administration and the appointment of such a committee was practically ordered by the President. President Wilson's problem thus had become very complex. He was called upon not only to make choice of a banking bill which he could indorse, but also practically to give his word to members of his party for the appointment of a committee and the enactment of legislation. Congress was at the time restive and indisposed to proceed, the leaders particularly threatening danger should effort be made to enact a banking bill at the session then in existence, and urging delay and further study. The President, however, had fully realized the fact that an unusual and remarkable legislative opportunity was open to him—one which he and he alone could improve were he so minded. He resolved, therefore, to direct the appointment of a House Banking and Currency Committee and did in fact practically instruct the House

leaders to select it. Consequently the House leaders, acting under the compulsion of the administration, had receded from their original refusal to name any committees except that on Ways and Means, and named the new Committee on Banking and Currency. While it contained a number of former members of Congress it was in large part composed of new faces. The old members of the Committee were scarcely more than half a dozen in number and of these not all were in sympathy with the purposes of the new measure.

Effort to Undermine Committee

Opponents of the legislation at once began an endeavor to defeat the Committee by working among its membership. It was represented to the new appointees that, instead of waiting for the Committee to be organized, the administration had proceeded to draft a bill which it was now intended to force upon the organization. Radical Democrats in Congress, although disappointed in their effort to obtain the support of Mr. Bryan in antagonizing the measure, were inclined to suggest that Mr. Bryan's feeling was really adverse to the bill, notwithstanding he had in some unaccountable way been induced to support it. It became evident almost immediately that a lengthy process of discussion and amendment would be necessary before the proposed plan could be expected to receive the approval of the Committee. This process was, however, initiated early in July, when regular sessions were begun and the drafting of amendments was undertaken. The plan was that of holding a daily meeting devoted to work with the full membership, reading the bill section by section, explaining it and introducing changes wherever deemed essential.

Three Groups in Committee

Within the Committee itself there speedily developed three principal sections of opinion. One group consisting

of irreconcilable Democrats and ultra-progressive Republicans was opposed to the bill on principle and continued to be so throughout its entire history. A second group consisted of agricultural Democrats who, while not opposing the measure in the aggregate or as a whole, were disposed to insist upon its extensive modification in various ways that were designed to be of assistance to the farming population. It would be somewhat difficult to say precisely what was gained by these elements in the Committee. Changes were made from day to day, in many cases found unsatisfactory or inadequate or out of harmony with other phases of the bill as framed and finally abandoned. In general, however, it is fair to say that the critical attitude of the agricultural element in the Committee resulted in the liberalization of the commercial paper clauses of the bill to some extent, in order that there might be a larger latitude for the discounting of agricultural paper. It may well be questioned whether the original language of the bill was not for the most part so drafted as to permit the discounting of all legitimate commercial paper growing out of agricultural operations, if the administrative board in charge of the management of the system should so choose. But the agricultural group doubtless secured the definite recording of this more liberal judgment in the terms of the law. As the system eventually worked out, especially after the compulsory concentration of reserves which took place in June, 1917, these changes were probably beneficial or at all events not hurtful. The same could not be said perhaps of the change of language which included within the limits of eligible paper not only that which was discounted as the result of the use of funds in commercial, industrial, and agricultural operations but also that which was discounted for the purpose of providing funds "to be used" in this way. In this change there was involved a problem of principle affecting the use of banking funds for actual constructive and productive purposes still to be attained.

as contrasted with the use of such funds only for the liquidation of rights or interest growing out of operations of a productive or constructive nature already undertaken. Yet here, too, the changes made were never more than such as could still be subject to the control of a properly qualified administrative board. The so-called "concessions to agricultural interests" which were widely advertised in the press during the progress of the Committee discussions were thus only those which had been open to these interests at all times and consisted in the main merely in the clarification or rectification of language which did not perhaps sufficiently guarantee the right consideration of applications based on farming business.

Irreconcilables Won Over

The element in the Committee which was irreconcilable at the outset continued to offer opposition for many weeks. There was for a long time no convincing those members who were persuaded that the bill was designed to work in the interest of the Money Trust and who were determined to adhere to their position in the extreme left wing of the party. Eventually, however, most of them were undoubtedly shaken in their opposition and so far as they sustained it, did so only for the sake of consistency. Before the work had gone far the chairman and his associates found it expedient to discontinue any definite attempt to conciliate them, save in so far as to give them full liberty of proposing changes and where they were beneficial or harmless to the purpose of the measure, permitting their incorporation. Republicans of course maintained a theoretic opposition though actually in sympathy with the essence of the work. One wholly irreconcilable Republican, Representative Lindbergh—the subsequent author of a book entitled "The Money Trust"—displayed violent antagonism and eventually filed minority views designed to attack the whole purpose of the measure. Mr. Lindbergh, however, had few supporters and was unable to make head-

way with his opposition. Whether through lack of sympathy or because of party differences he never united with the Democratic opposition, and while, had it been possible to unite all antagonistic votes within the Committee into a compact group regardless of party, considerable difficulty might have been placed in the way of the measure, the situation never really came to that pass.

Measure Improved

On the whole the Federal Reserve Act emerged from the House Banking and Currency Committee improved in various particulars¹. The consideration given to it had developed a number of points at which the language could be considerably strengthened and then permitted the incorporation of a variety of features which tended to popularize the measure and perhaps really improve its technique. Perhaps the most noteworthy of these were seen in the better definition of the powers of the Reserve Board, particularly with respect to inter-reserve discounts and the introduction of a provision for a body known as the Federal Advisory Council. This Council was to consist of one banker from each reserve district, to be chosen by the federal reserve bank of that district through its board of directors and to represent the general banking opinion of the community. The Council was to meet quarterly in Washington and was to consult with the Federal Reserve Board. This provision was all that it proved practicable, or was deemed desirable, to salvage from the original section providing for a Federal Reserve Board which should consist in part of banking members. In lieu of this provision which, as seen in a former chapter, had been eliminated in the negotiations with Mr. Bryan, there now appeared the provision for a semiofficial body of bankers consulting

¹ The question of interlocking bank directorates received much attention but was put aside as not germane. Action on this question was strongly urged by the Bryan Democrats but Mr. Bryan himself wrote Chairman Glass a letter given in the Appendix to this Chapter.

with the Board and possessed only of vague advisory powers which might or might not at times become significant. As the experience of the system showed in later years, the powers of the Federal Advisory Council were not sufficient, or perhaps its composition was not such as to give it at any time a very active part in system affairs. Indeed, it would be difficult to say up to the close of the system's eighth year that the Council had ever exerted a very important influence. The war period afforded opportunity for it to offer some useful and valuable suggestions, but these were in most cases made direct to the Treasury Department or were transmitted to it through the Board. About the same kind of advice would have been obtained in any case through informal consultations between the banking community and the Treasury. As for system matters, it was tolerably plain from the outset that the Council could not participate very directly. These facts were recognized and the insertion of a provision referred to was not strongly resisted even by the so-called "radicals." In other directions the work done for the improvement of the language of the bill was helpful and resulted in beneficial modifications. It was on the whole a stronger measure as it emerged from the Committee than it was when it entered that body. Moreover, the members of the House as a whole had been kept advised of the progress of the discussions and had been brought much more fully into sympathy with the measure than they had been at the time of its introduction or for a period of several weeks thereafter.

The bill as thus modified has been fully considered at another point and what is here intended is merely to sketch the relationships between the administration and Congress, or, in other words, the political history of the measure in its broadest sense. Thoroughly committed as it now was to the furtherance of the Glass bill, the administration undoubtedly felt called upon to exert every effort to secure the adoption

by obtaining a sufficient number of votes in the Committee to insure its being reported in due time. Probably enough votes would have been available in any case, but it was of course deemed desirable to make the action as nearly unanimous as possible in order that subsequent support on the floor might be good and in order to present a united front to the public.

But even this strong support would probably not have sufficed to attain the desired object, had it not been for the steady and conscientious work in behalf of the bill done by the chairman himself and by those who had been chiefly instrumental in furthering the measure with a view to explaining and setting forth its chief elements. The fact that they were willing to accept suggestions and introduce changes at any point where a reasonable case could be made out, undoubtedly had much influence with the membership of the Committee. As the summer passed the members of the Committee, and through them the members of the House, became more and more familiar with the meaning of the language employed and more and more inclined to shape the bill along sound and scientific lines. One consequence of this situation was found in the fact that not a few changes, first introduced as matters of compromise or concession, were subsequently eliminated, the terms of the bill being put back substantially to their original form, whenever it was recognized that the innovations tentatively made by agreement had not been beneficial. In order to understand the facts as to the situation in the Committee and subsequently in the House politically, it is now necessary to suspend for the time being the discussion of the legislative and executive history of the measure and to go back some months for the purpose of considering the factors which had been at work in the business and banking community with reference to the measure and the general nature of the attitude which they had developed in regard to it.

Crystallization of Hostility

At an earlier point it has been explained that no publication of the terms of the bill in detail had been deemed wise up to the time when the actual form of the measure had been determined. It has been pointed out, however, that at no time was there any hesitation in explaining to individuals or organizations who made direct inquiry, the general lines along which the Committee was working and the objects which it had in mind. The attitude of the banking community during the summer and autumn of 1912 had been one of almost complete indifference toward the whole undertaking. General belief that no matter how the election turned out it would be impossible to resist the positive demand for the National Monetary Commission bill, or something analogous to it, continued to prevail and there was a disposition to insist that the efforts which were being made to develop a new measure were purely political and would turn out to be ineffectual.

Some change in this attitude began to make itself evident immediately after the close of the hearings. The fact that nothing had been made public in an official way tended to convince the business community that there was no ulterior political object in view and that whatever had been done was for the sake of informing those who had new legislation at heart and who would be likely to make use of the results of the study in some practical manner. The hearings themselves, conducted as they were plainly for the sake of getting information, impressed those who were in attendance that an actual bill was being formulated. After the new administration came into office, enough had become known concerning the work that was in progress to confirm many bankers in the opinion that they ought to find out definitely what was contemplated.

Inquiry of Bankers Association

Perhaps the first official effort looking in this direction was made by a committee representing the American Bankers

Association, whose executive council was about to hold its spring session at Briarcliff, near New York City.² This committee first visited Washington and reviewed the general plans relating to the bill with Chairman Glass, then visited New York for the purpose (at the suggestion of Mr. Glass) of reviewing the general outlines of the measure in somewhat greater detail with the author. A discussion of principles and general methods to be pursued occurred at the Princeton Club on the evening before the meeting of the council at Briarcliff. After the general purpose of the bill had been sketched the chairman of the committee encouraged some expression of opinion from those present and received from one or more the frank statement that in all probability the measure if adopted as proposed would give rise to "the damndest panic this country has ever seen." The report made on the following morning to the council was more conservative in expression but far from encouraging and undoubtedly had an important effect in leading bankers to the opinion that something very hazardous was being planned.

New York Financiers Interested

New York bankers also for the first time undertook to inform themselves of the progress that was being made in the drafting of the bill and some of those who during the preceding autumn and winter had been inclined to ridicule the notion that anything could really be accomplished now accepted without reservation the fact that there would be in all probability an administration measure whose terms they would have to reckon with. The McAdoo plan had become known to only a relatively small proportion of bankers and among these to only a few in New York. But the gossip concerning its terms and the fears undoubtedly entertained by some of those to whom it had been broached spread widely and tended to increase the general uneasiness. Offsetting the anxiety which

² April, 1923

prevailed in a number of quarters was probably the more reassuring and moderate point of view adopted by some bankers like A B Hepburn, who had been more or less conversant with the efforts that had been making and who felt a certain degree of confidence that the attempt to frame a satisfactory banking bill was at least honest. These, however, were in the minority, and such knowledge as they had was not of the kind which they were at liberty to publish broadcast. The result was the unmistakable development of doubt and suspicion.

Among others who had become very desirous of knowing what was to be proposed and what might be expected as a result were various commercial and other organizations. Included in the number was the National Citizens' League, whose origin and work has been briefly referred to at another point. The chief executive of this organization, Mr J V Farwell of Chicago, a merchant of national standing, visited New York and sought through personal inquiry to ascertain the exact position of affairs. He was advised to the same effect as the representatives of the American Bankers Association and others who had made like inquiry. Thinking over the situation, Mr. Farwell on behalf of his organization, apparently, wrote the author on April 24, 1913, as follows:

First In regard to obliging country or other banks to give their depositors exchange free, within the district in which the bank is located, I believe this would be very unwise.

The bank keeps its balances in various parts of the country, where its customers are likely to need the money, those balances being useful only for that purpose. If it is obliged to keep these balances without any profit, but on the contrary with a loss, it would be unnecessary hampering of the banks in their operations, and, to my mind, unfair to them.

I see no reason why *banks* keeping accounts at district centers should not transfer their balances to one another, with little if any cost—just as the district association, through the medium of the clearing house department, about which we talked, could transfer their balances, without any cost.

This reduction of the cost to the banks would naturally lead to smaller charges made to their customers. With this arrangement made, such charges could be left to competition, and not made an arbitrary matter to the bank.

There are some accounts in the banks which ask for very little exchange, and others, like ours, who are asking for it every day, so that the accounts which are not asking for the exchange would have to bear the expense incurred by the bank for those who do, in case they were obliged to give exchange free. This, to my mind, would not be fair. Every individual account should, as much as possible, pay the expense incident to its own operation.

This is the English and foreign method, even to the extent of stamps. This, however, is the extreme, which naturally would not be followed in this country.

President Wilson, I have heard, is in favor of competition and no parental control over the ordinary operations of the bank.

Second As to the number of regional banks, I am very firmly of the belief that the success of the whole plan depends on having not over seven of them, that five would be much better.

There can be as many sub-agencies as the country demands, but the units of discount and reserve should be large, broad and strong.

It is infinitely better, for instance, that Omaha should be the sub-agency of Chicago than to be the head of a district of its own.

It would give much surer and prompter relief to its own section than it could under a plan of having a large number of regional banks. It seems to me this is self-evident. It would be certainly somewhat paradoxical to have one big bank in a district almost as large as the district association, which is supposed to help it in time of trouble. This might easily occur if we had the country cut up in small districts. Such a case would almost resolve itself into a bank trying to lift itself up by its own boot straps. It might also take most of the money and prevent the smaller banks from getting any. It certainly would be a source of weakness to the whole system.

I give this as rather an extreme illustration, but it can, perhaps, "point the moral" more easily.

Third I trust you will be able to talk over with the committee what I discussed with you, as to an increasing gradual check on the re-discounts by banks, on the principle of having a higher charge for the second third, and a still higher charge for the third third, which is to be re-discounted. I earnestly believe this to be very important,

as it will check inflation "at its source," and do it gradually and not with a jar

Some of the best judges of the country, including Mr Hulbert of the Merchants Loan and Trust Company, and banker friends of mine in Boston and elsewhere, agree with me absolutely on this Mr Hulbert, as you know, is a great friend of Mr Wilson, was consulted by him when he came to Chicago, and would, I am sure, emphasize this, if Mr Wilson, or any one, asked his opinion on the subject

I regard it not as one of the details but as one of the essentials to the success of the plan

Fourth As to changing the reserve laws, as to reserve cities and central reserve cities,—it seems to me that this important change should not be made at this time

The country will be going through enough re-adjustment, with the new tariff bill passed, and the reform in banking system, without adding this very great change of the reserve system

While I believe, scientifically, it should be done, I do not believe now is the time to do it

We are going to have a trying time this fall, anyway, and the various changes and big crops are going to accentuate it I do not believe in giving the patient a second operation until he has had time to recover from the first

As this reserve change will be very radical, it might produce a good deal of trouble at this time For that reason I feel strongly against any such requirement being embodied in the present law

Let them take one step at a time, as has been intimated they are going to do Is not that much the safest course?

(Signed) JOHN V FARWELL

Opposition of Organized Interests

This position as expressed by Mr Farwell, representing as he did an organization understood to ramify widely throughout the United States and to have the support of the banking public, is of large interest in the history of the Federal Reserve Act It definitely showed for the first time what soon came to be recognized both in and out of Congress—that the fundamental principles of the reserve measure, the transfer of reserves, the establishment of a satisfactory collection system, and others, were not favored by the organized interests which

had been supporting the Aldrich banking plan but were by them regarded with distaste to say the least. Mr. Fairwell's opinion as thus expressed was not merely his own, but, as speedily became apparent, represented the views of many bankers and business men the nation over. The attitude was largely inspired by the reserve city bankers on the one hand who were indisposed to lose (as they supposed they would) their country bank deposits, and on the other hand by country bankers who were indisposed to lose the heavy exchange and collection charges which they were then receiving. The result of this increasing opposition was to build up in the several congressional districts a very heavy backfire upon members of Congress with the purpose of preventing in the first place the immediate consideration of the federal reserve measure and, if that should prove impossible, of preventing the furtherance of its progress through Congress.

Citizens' League Hostile

It has sometimes been supposed and suggested that this opposition was the result of misunderstanding of the new bill and that the "secrecy" which surrounded it had defeated its own alleged object. As to that the following letter from Mr. Farwell, sent the author immediately after the new bill had become public and dated June 23, affords information.

I am very much disappointed in the product,

It is apparently to be a politically controlled institution, and full of Bryan virus, and of notes that "purport" to be the obligations of the United States. It is a most unscientific arrangement, and will produce a hybrid responsibility.

As you know, I have been fearing the change in the reserve system. I note they have made these changes in a much more radical way than I imagined they would. In fact, in doing some figuring, I find there will not be enough money to go around, as that part of the Bank reserves which is deposited with the other banks is simply represented by ledger balances and is not cash. I take it these Federal banks are going to receive cash only, and that balances are to be built up only in that way or by borrowing. There will be no reciprocal banking

accounts between the Federal banks and member banks but only accounts one way, and that with the Federal banks

I do not believe that experts in the Treasury Department have figured this out carefully enough. I enclose a rough statement on the subject, and if you see any flaws in it I shall be very glad to have you let me know.

Our League is going to go over this matter thoroughly this week, and will probably make some kind of a statement on the subject, which we will follow up with the views of our various state organizations.

Attack of Monetary Commission Element

The publication of the new bill was in fact received with a chorus of disapproval and was particularly productive of attack among those who had supported the Aldrich or National Monetary Commission bill. It seems strange today in looking back upon the history of the Federal Reserve Act to hear it asserted that the federal reserve measure was a copy of or plagiarism from the Aldrich bill. As to that the almost immediate hostile review of the measure made by the Hon. A. Piatt Andrew, formerly Assistant Secretary of the Treasury and Assistant to the Monetary Commission, should be conclusive. It was, moreover, positive evidence as to the position to be immediately assumed by the banking and business community in general with respect to the bill. In fact, it shortly seemed as if there was no support whatever for the measure in any quarter.

As yet, indeed, it was too early for the opposition to the bill to assume an organized form but that opposition was exceedingly influential in shaping the immediate political situation in Congress. How extensively and systematically the opposition campaign was later developed will appear at another point. What is said here is merely intended to throw light upon the conditions which the administration had immediately to deal with in securing an adoption from the House. Time was recognized as the essence of the situation and, as already noted, every effort had been made to get prompt action from

the Banking and Currency Committee Of all this the opponents of the measure were well aware and not a few of them began an immediate campaign designed to stop the bill in the House, even though at this early date it was recognized that the best line of defense would be found in the Senate One form of attack strongly prosecuted was that of sending to members of the Banking and Currency Committee adverse expressions of opinion prepared by leading bankers

J B. Forgan's Criticism

One such was furnished by Mr J B Forgan, then president of the First National Bank of Chicago and a man nationally respected not only for his importance in a financial way but for his personal probity Mr Forgan in a pamphlet which was distributed among the Committee as well as among members of the House of Representatives at large severely attacked the new measure, asserting that it would cause danger and, perhaps, disaster Said Mr Forgan in a later issue of his views entitled "Review of Proposed Banking and Currency Bill"

Three objections to the regional reserve associations occur to us

First, they will divide the cash reserves of the country into as many different ownerships as there are regional associations

Second, in connection with the shipping of reserve money from one section of the country to another in times of financial stress this might produce an undesirable and awkward situation, the interests of the various sections of the country being at variance

Third, under one ownership and control of the reserves transfers of funds could under normal conditions be accomplished by book entries rather than by shipment of money

Nearly every other provision of the measure received severe criticism from Mr Forgan

Political Situation in Committee and House

Just what the effect of these onslaughts upon the new bill may be considered to have been has always been a matter of doubt. An obstacle to the development of a successful resistance within the House Banking and Currency Committee was found in the fact that so few of the members came from districts which could be easily reached and influenced by those who were opposing the measure. Then, too, the element of surprise was the important factor, for although, as already carefully explained, the work of the Committee had not been surrounded by secrecy, it was a fact that the banking public throughout the country had paid but little attention to what was being done. But more important than any of these considerations was the fact that the House of Representatives was essentially a radical Democratic body, so that the dislike expressed for the bill among the larger merchants and bankers perhaps helped rather than hurt it. If this was a regrettable and in some ways unworthy situation, it need not on that account be ignored. As has been elsewhere seen, the Money Trust investigation had strengthened and deeply rooted the anti-capitalistic sentiment in the Democratic party. Many members who were not much informed on the subject of banking and who were disposed to get their ideas on that topic from some outside source seemed actually converted to the measure by the fact that it had proved distasteful to the conservative elements in the community. The circumstance that it had been indorsed by Mr. Bryan tended to solidify their belief that the bill would be inimical to the banks, and being thus assured by their own leaders that the measure was one of progressive variety, while informed by conservatives that it was hazardous in the last degree, their minds became firmly set upon the adoption of it. Thus as one faithful party man expressed it, they were ready to vote for it "with their eyes shut."

The final outcome of the forces acting upon the Committee

from within and from without was an agreement upon essential principles and a unanimous report in which they were embodied. The general or introductory portion of this report reviews the basis that had thus been accepted and is reproduced as showing the outcome of the work done by the Committee in determining the general principles of its action, regardless of the demands of outside interests.³

GENERAL PRINCIPLES

The committee . . . reached in general the following conclusions

1 The idea of centralization or cooperation, or combined use of banking resources, is the basic idea at the root of central banking argument

2 It is not necessary in order to obtain the benefits of the application of this idea that there should be one single central bank whose activities should be coterminous with the limits of a nation's territory

3 Equally good results can be obtained by the federating of existing banks and banking institutions in groups sufficiently large to afford the strength or cooperating power which is the chief advantage of the centralization

4 In the United States, with its immense area, numerous natural divisions, still more numerous competing divisions, and abundant outlets to foreign countries, there is no argument either of banking theory or of expediency which dictates the creation of a single central banking institution, no matter how skillfully managed, how carefully controlled, or how patriotically conducted

5 It is therefore necessary to abandon the idea of a single central banking mechanism for the United States unless it shall be found that there are considerations of expediency which would dictate a resort to this policy

6 For reasons which will be stated at a later point the conviction was formed not only that there are no such reasons of expediency, but that every consideration of that character would lead to action of an opposite nature

It was therefore decided that throughout its efforts to formulate a banking measure there should be no necessary attempt to base the result of the bill upon the central banking idea. Only in so far as

³ Report prepared by the author at the request of Chairman Glass and the Democratic majority of the Committee

that idea indicated an easy and natural adjustment to existing institutions and conditions was it to be given a place in the ultimate findings.

BRANCH BANKING SYSTEM

Many bills have been introduced into Congress from time to time for the establishment of branches of existing national banks, and the system has so widespread and respectable a support as to make it apparent from the outset that this aspect of banking theory and practice should be considered. The eminent success of the Canadian banking system and of others similar to it enforces upon the most indifferent student of the subject the significance of branch banking as a means of securing cooperation and the junction of resources in support of any weak element in a banking system that may have been subjected to attack at a given moment. It is clear that Canada, for example, with her 27 banks and thousands of branch banks, represents a distinctly different type of banking from that which is exemplified by the national banking system with its 7,473 independent banks, none of which possesses a single branch formed under the national banking act. The question was thus clearly to be considered whether the bestowal of the branch power would in fact meet the difficulties of the present situation in the United States. Careful study of the applicability of the Canadian banking system to American conditions convinced the committee that an adaptation of it would not be feasible to-day. The successful introduction of the branch system would almost necessarily have meant the abandonment of the idea of free banking. While it would not necessarily have been requisite to abandon free banking in theory in order to introduce the Canadian principle, it would have been practically true that the power of establishing branch banks, if widely exercised by large national institutions, would have entailed the contracting of the number of independent banks in the United States and a corresponding limitation of the perfect freedom of competition which exists to-day. Certainly it would not have been possible to introduce the principles of the Canadian system into American banking without a very extensive and vital modification of banking legislation and conditions in the United States. That the country was prepared for so profound a modification, not to say transformation, of the basic ideas upon which the national banking system has been developed the committee did not believe and it was therefore led to the abandonment of all thought of attempting a plan of banking reform based upon the conception of large privately managed insti-

tutions operating unrestrictedly and with great numbers of branches. This conclusion did not, of course, imply any belief that the adoption of other features of the Canadian system which seemed applicable and could be easily grafted upon our own system was undesirable. It was a conclusion relating simply to one of the general ideas underlying the structure of Canadian banking.

QUESTION OF NOTE ISSUES

Very early in its inquiries the committee was necessarily confronted with the question whether a mere reconstruction of the note-issue system of the United States would suffice to furnish the basis for banking reform. Ten years ago and earlier, the dominant note in banking reform literature seemed to be that of elasticity in currency, and it was frequently urged by men of widely different political beliefs, and of totally varying views as to the theory of money and banking that the whole problem was essentially a matter of currency issue. The bankers who urged the creation of an asset currency and the public men who recommended the issuance of additional United States notes or Treasury notes, whether protected or unprotected, were fundamentally alike in their belief that the whole trouble with existing banking lay in a difficulty in securing proper supplies of currency when needed and of withdrawing them when not needed.

A careful study of this phase of banking discussion convinced the committee most unmistakably that those who would regard the banking and credit problem as soluble through the proper treatment of the paper currency question solely were accepting a superficial view of the real elements of the difficulty. As is well known, the bank extends its credit in two forms, either (1) by the granting of a book credit or "deposit" or, (2) by the issuing of notes. There is no essential difference between these two forms of credit, if they are protected by similar reserve funds, except that they are likely to have a different term of existence, the deposit credit being ordinarily redeemed much more rapidly and efficiently than even the most elastic note issues. To provide therefore for a free issue of note currency, whether by the Government or by the banks, would not meet the need for a more effective supply of deposit credits. In times of stress the difficulty under which banks labor is not usually that of lack of assets, but is that of inability to convert good assets into a medium that can be used in making payments. However desirable it might be to be able to turn sound and liquid commercial assets into a note currency payable to anyone willing to receive it, and however desirable it might

be to obtain a free issue of Government legal-tender notes obtainable by any individual who might possess property of specified classes, such notes would plainly not meet the needs of those who desired the book form of credit. While they might indeed be converted into book credit by depositing them with the banks, such a course would have entailed many incidental consequences that should not have been made prerequisite to the obtaining of means of payment. It was felt therefore that a return to the older conception of banking reform as being primarily a problem of securing easily expansible supplies of notes would not meet the needs of the situation to-day, and even though it should prove to be of some temporary value in times of special stress would not constitute that permanent and reliable support to business credit that was sought. It was therefore concluded that while a proper issue of note currency should necessarily be included as a feature in any measure to be recommended it could not be taken as the sole or even the primary purpose of such legislation.

CLEARING-HOUSE ORGANIZATION

Another type of plan that has been frequently urged by students of banking conditions in the United States is that of clearing-house organization. It has been suggested that inasmuch as the clearing-house associations of the country represent a kind of voluntary association among bankers—one, too, that has already been frequently and successfully availed of in time of stress—it would be well worth while to endeavor to base such new organization as might be favored upon the clearing houses of the country. Various plans for this purpose have been worked out with more or less success. The Aldrich-Vreeland law, already frequently referred to, was a partial application of this idea, although before the act was finally adopted it had become necessary to modify in very great degree the original clearing-house principles upon which the plan was in the first instance founded. Most such plans have proceeded upon the theory that it was entirely feasible to compel banks to join national clearing-house associations which should be incorporated and over which the Government should exercise a measure of control. To these incorporated clearing houses, it has been suggested, could be committed the function of issuing "emergency currency" based upon the joint assets of the banks, thus providing for regular and authorized employment of the method of credit extension which has been made use of in times past when stringent conditions had developed themselves in the banking community. It has not been deemed wise upon examination to attempt

any device of this sort. If the clearing houses as thus recognized and authorized perform their functions of credit extension only occasionally and sporadically they remain an emergency expedient. The committee is convinced that what is needed is not a means of remedying emergencies after they have arisen but a plan for guarding against the development of such emergencies and for so protecting the community that it will not be under the necessity of calling for the use of abnormal devices in its interest. If the clearing-house associations referred to should be organized upon a permanent basis with a view to making such extensions of credit as a regular and normal incident of business, they would not in any material respect differ from banking institutions. The retention of the name "clearing houses" would then be misleading and could not be defended. From no point of view, therefore, has the plan suggested commended itself. This does not signify that the idea of cooperative effort embodied in the clearing-house plan is unsatisfactory, but, as will be seen later, quite the contrary. It does mean that the use of existing clearing-house machinery for the purpose of granting accommodation under exceptional conditions does not seem to the committee to be a wise method of providing the credit resources that are needed in effecting a thorough reform of the banking and currency system of the country.

OTHER PLANS INADEQUATE

Of the multitude of other plans, some beyond the confines of reasonableness, others more or less conforming to actual necessities and to legitimate principles of banking and currency legislation, nothing need be said except that none has been found which, in the opinion of the committee, is at the same time feasible, available, trustworthy, and sufficiently inclusive to afford a thorough basis of reform of the present conditions. The committee does not feel that the legislation now to be adopted should seek to include within its scope all the possible features upon which action is required, but rather that it should attempt to lay a foundation for future development by selecting those elements in the situation that are most in need of attention and seeking to deal thoroughly with the problems offered in this more restricted field of action. It has therefore put aside many schemes of reform which, however desirable they might abstractly be, do not conform to the standards already outlined. It has limited itself to the fundamental necessities of the present situation as it views them and has sought to keep its recommendations within narrow scope in order that no extraneous issues might become

involved with the general problem which lies at the base of further improvement. It has deferred the thorough reform of the national-bank act on its administrative side, and it has determined to postpone, in like manner, the question of long-term agricultural credit, firmly believing that neither of these subjects can be adequately dealt with until the substructure of banking organization has been remodeled.

FUNDAMENTAL FEATURES OF REFORM

After looking over the whole ground, and after examining the various suggestions for legislation, some of which have just been outlined, the Committee on Banking and Currency is firmly of the opinion that any effective legislation on banking must include the following fundamental elements, which it considers indispensable in any measure likely to prove satisfactory to the country:

1. Creation of a joint mechanism for the extension of credit to banks which possess sound assets and which desire to liquidate them for the purpose of meeting legitimate commercial, agricultural, and industrial demands on the part of their clientele.

2. Ultimate retirement of the present bond-secured currency, with suitable provision for the fulfillment of Government obligations to bondholders, coupled with the creation of a satisfactory flexible currency to take its place.

3. Provision for better extension of American banking facilities in foreign countries to the end that our trade abroad may be enlarged and that American business men in foreign countries may obtain the accommodations they require in the conduct of their operations.

Beyond these cardinal and simple propositions the committee has not deemed it wise at this time to make any recommendations, save that in a few particulars it has suggested the amendment of existing provisions in the national-bank act, with a view to strengthening that measure at points where experience has shown the necessity of alteration.

PROPOSED PLAN

In order to meet the requirements thus sketched, the committee proposes a plan for the organization of reserve or rediscount institutions to which it assigns the name "Federal reserve banks." It recommends that these be established in suitable places throughout the country to the number of 12 as a beginning, and that they be assigned the function of bankers' banks. Under the committee's plan these banks would be organized by existing banks, both National and

State, as stockholders. It believes that banking institutions which desire to be known by the name "national" should be required, and can well afford, to take upon themselves the responsibilities involved in joint or federated organization. It recommends that these bankers' banks shall be given a definite capital, to be subscribed and paid by their constituent member banks which hold their shares, and that they shall do business only with the banks aforesaid, and with the Government. Public funds, it recommends, shall be deposited in these new banks which shall thus acquire an essentially public character, and shall be subject to the control and oversight which is a necessary concomitant of such a character. In order that these banks may be effectively inspected, and in order that they may pursue a banking policy which shall be uniform and harmonious for the country as a whole, the committee proposes a general board of management intrusted with the power to overlook and direct the general functions of the banks referred to. To this it assigns the title of "The Federal reserve board." It further recommends that the present national banks shall have their bonds now held as security for circulation paid at the end of 20 years, and that in the meantime they may turn in these bonds by a gradual process, receiving in exchange 3 per cent bonds without the circulation privilege.

In lieu of the notes, now secured by national bonds and issued by the national banks, and, so far as necessary in addition to them, the committee recommends that there shall be an issue of "Federal reserve Treasury notes," to be the obligations of the United States, but to be paid out solely through Federal reserve banks upon the application of the latter, protected by commercial paper, and with redemption assured through the holding of a reserve of gold amounting to $33\frac{1}{3}$ per cent of the notes outstanding at any one time. In order to meet the requirements of foreign trade, the committee recommends that the power to establish foreign branch banks shall be bestowed upon existing national banks under carefully prescribed conditions and that Federal reserve banks shall also be authorized to establish offices abroad for the conduct of their own business and for the purpose of facilitating the fiscal operations of the United States Government. Finally and lastly, the committee suggests the amendment of the national-bank act in respect to two or three essential particulars, the chief of which are bank examinations, the present conditions under which loans are made to farming interests, and the liability of stockholders of failed banks. It believes that these recommendations, if carried out, will afford the basis for the complete reconstruction and

the very great strengthening and improvement of the present banking and credit system of the United States. The chief evils of which complaint has been made will be rectified, while others will at least be palliated and put in the way of later elimination.

FEDERAL RESERVE BANKS

The Federal reserve banks suggested by the committee as just indicated would be in effect cooperative institutions, carried on for the benefit of the community and of the banks themselves by the banks acting as stockholders therein. It is proposed that they shall have an active capital equal to 10 per cent of the capital of existing banks which may take stock in the new enterprise. This would result in a capital of something over \$100,000,000 for the reserve banks taken together if practically all existing national banks should enter the system. It is supposed, for a number of reasons that the banks would so enter the system. More will be said on this point later in the discussion. How many State banks would apply for and be granted admission to the new system as stockholders in the reserve banks can not be confidently predicted. It may, however, be fair to assume at this point that the total capital of the reserve banks will be in the neighborhood of \$100,000,000. The bill recommended by the committee provides for the transfer of the present funds of the Government included in what is known as the general fund to the new Federal reserve banks, which are thereafter to act as fiscal agents of the Government. The total amount of funds which would thus be transferred can not now be predicted with absolute accuracy, but the released balance in the general fund of the Treasury is not far from \$135,000,000. Certain other funds now held in the department would in the course of time be transferred to the banks in this same way, and that would result in placing, according to the estimates of good authorities, an ultimate sum of from \$200,000,000 to \$250,000,000 in the hands of the reserve banks. If the former amount be assumed to be correct, it is seen that the reserve banks would start shortly after their organization with a cash resource of at least \$300,000,000. As will presently be seen in greater detail, it is proposed to give to the reserve banks reserves now held by individual banks as reserve holders under the national banking act for other banks. Confining attention to the national system, it is probable that the transfer of funds thus to be made by the end of a year from the date at which the new system would be organized would be in the neighborhood of \$350,000,000. If State banks entered the system and conformed to

the same reserve requirements they would proportionately increase this amount, but for the sake of conservatism the discussion may be properly confined to the national banks. For reasons which will be stated at a later point, it seems likely that at least \$250,000,000 of the reserves just referred to would be transferred to the reserve banks in cash, and if this were done the total amount of funds which they would have in hand would be at least \$550,000,000. This would create a reservoir of liquid funds far surpassing anything of similar kind ever available in this country heretofore. It would compare favorably with the resources possessed by Government banking institutions abroad.

It will be observed that in what has just been said the reserve banks have been spoken of as if they were a unit. The committee, however, recommends that they shall be individually organized and individually controlled, each holding the fluid funds of the region in which it is organized and each ordinarily dependent upon no other part of the country for assistance. The only factor of centralization which has been provided in the committee's plan is found in the Federal reserve board, which is to be a strictly Government organization created for the purpose of inspecting existing banking institutions and of regulating relationships between Federal reserve banks and between them and the Government itself. Careful study of the elements of the problem has convinced the committee that every element of advantage found to exist in cooperative or central banks abroad can be realized by the degree of cooperation which will be secured through the reserve-bank plan recommended, while many dangers and possibilities of undue control of the resources of one section by another will be avoided. Local control of banking, local application of resources to necessities, combined with Federal supervision, and limited by Federal authority to compel the joint application of bank resources to the relief of dangerous or stringent conditions in any locality are the characteristic features of the plan as now put forward. The limitation of business which is proposed in the sections governing rediscounts, and the maintenance of all operations upon a footing of relatively short time will keep the assets of the proposed institutions in a strictly fluid and available condition, and will insure the presence of the means of accommodation when banks apply for loans to enable them to extend to their clients larger degrees of assistance in business. It is proposed that the Government shall retain a sufficient power over the reserve banks to enable it to exercise a directing authority when necessary to do so, but that it shall in no

way attempt to carry on through its own mechanism the routine operations of banking which require detailed knowledge of local and individual credit and which determine the actual use of the funds of the community in any given instance. In other words, the reserve-bank plan retains to the Government power over the exercise of the broader banking functions, while it leaves to individuals and privately owned institutions the actual direction of routine

TRANSFER OF RESERVES

Reference has been briefly made to the fact that the committee's proposals provide for the transfer of bank reserves from existing banks which hold them for others to the proposed reserve banks. At present the national banking act recognizes three systems of reserves.

(1) Those in central reserve cities, where banks are required to hold 25 per cent of their deposit liabilities in actual cash in the vaults, while banks situated outside of such cities are allowed to make certain deposits with them which shall count as a part of the reserves of such outside banks.

(2) Those in reserve cities, 47 in number, which are required to keep a nominal reserve of 25 per cent, 12½ per cent of this being in cash in their own vaults, while 12½ per cent may consist of deposits with banks in central reserve cities.

(3) Those in the "country," by which is meant all places outside of central reserve and reserve cities, it being required that such banks shall nominally keep 15 per cent of their deposit liabilities, of which 6 per cent is held in cash in their vaults and 9 per cent may be held in the form of balances with other banks in reserve and central reserve cities.

The original reason for creating this so-called "pyramidal" system of reserves was that inasmuch as central banking institutions were absent, and inasmuch as banks outside of centers were obliged to keep exchange funds on deposit with other banks in such centers, it was fair to allow exchange balances with such centrally located banks to count as reserves inasmuch as they were presumably at all times available in cash. This is an absolutely anomalous and unique system, found nowhere outside of the United States, and dangerous in proportion as the number of the reserve centers thus recognized increases beyond a prudent number. The law has almost necessarily been liberal in recognizing the power to increase the number of such centers, with the result that whereas but few existed just after the organization of the national bank act, there being then 3 central

reserve and 13 reserve cities, there are to-day 3 central reserve and 47 reserve cities. Even had this extension of the number of centers not occurred, the system established under the national banking act would still have been unsatisfactory. As matters have developed, it has been vicious in the extreme. Coupled with the inelasticity of the bank currency, the system has tended to create periodical stringencies and periodical plethoras of funds. Banks in the country districts unable to withdraw notes and contract credit when they have seen fit to do so, because of the rigidity of the bond-secured currency, have redeposited such funds with other banks in reserve and central reserve cities and have thus built up the balances which they were entitled to keep there as a part of their reserves. Moreover, the practice of thus redepositing funds having been once established, it has been carried to extreme lengths, and at times has been decidedly injurious in its influence. The payment of interest on deposits by banks in the centers has been used for the purpose of attracting to such banks funds which otherwise would have gone to other centers, or to other banks in the same centers or which would have been retained at home. The funds thus redeposited, even when not attracted by any artificial means, have of course constituted a demand liability, and have been so regarded by the banks to which they were intrusted.

In consequence, such banks have sought to find the most profitable means of employment for their resources and at the same time to have them in such condition as would permit their prompt realization when demanded by the depositing banks which put them there. The result has been an effort on the part of the national banks, particularly in central reserve cities, to dispose of a substantial portion of their funds in call loans protected by stock-exchange collateral as a rule. This was on the theory that, inasmuch as listed stock-exchange securities could be readily sold, call loans of this type were for practical purposes equivalent to cash in hand. The theory is of course close enough to the facts when an effort to realize is made by only one or few banks, but is entirely erroneous whenever the attempt to withdraw deposits is made by a number of banks simultaneously. At such times, the banks in central reserve and reserve cities are wholly unable to meet the demands that are brought to bear on them by country banks, and the latter, realizing the difficulties of the case, seek to protect themselves by an unnecessary accumulation of cash which they draw from their correspondents, thereby weakening the latter and frequently strengthening themselves to an undue degree.

Under such circumstances the reserves of the country, which ought to constitute a readily available homogeneous fund, ready for use in any direction where sudden necessities may develop, are in fact scattered and entirely lose their efficiency and strength owing to their being diffused through a great number of institutions in relatively small amount and thereby rendered nearly unavailable. This evil has been met in times past by the suspension of specie payments by banks and by the substitution of unauthorized and extra-legal substitutes for currency in the form of cashiers' checks, clearing-house certificates and other methods of furnishing a medium of exchange. Needless to say such a method of meeting the evil is the worst kind of makeshift and is only somewhat better than actual disaster.

HOLDING OF FUNDS

The committee believes that the only way to correct this condition of affairs is to provide for the holding of reserves by duly qualified institutions which shall act primarily in the public interest and whose motives and conduct shall be so absolutely well known and above suspicion as to inspire unquestioning confidence on the part of the community. It believes that the reserve banks which it proposes to provide for will afford such a type of institution and that they may be made the effective means for the holding of the liquid reserve funds of the country to the extent that the latter are not needed in the vaults of the banks themselves. To meet this end it proposes that every bank which shall become a stockholder in the new reserve banks shall place with the Federal reserve bank of its district a portion of its own reserve equal ultimately to 5 per cent of its demand deposits. Country banks would be required to keep 5 per cent in their own vaults, while the remaining 2 of a required total of 12 per cent might be at home or in the reserve bank of the district. In the case of reserve and central reserve cities the committee has felt that the change in their position as reserve-holding banks acting for other banks called for a corresponding change in the cash to be held by these banks. It has therefore reduced the gross reserve requirements from 25 to 18 per cent of deposits and the cash in vault requirement from 25 per cent in the central reserve cities to 9 per cent and from 12½ per cent in the reserve cities to 9. This places the two classes of reserve cities on an equal basis, leaves each ultimately with 9 per cent cash, requires each to keep 5 per cent in the reserve bank of the district, and permits each to keep a final 2 or 4 per cent either there or in its own vaults.

A period of three years is granted during which the deposits of country banks may be kept with the present correspondent banks in order that the latter may not be unduly embarrassed by sudden withdrawals while the new reserve banks will not be as suddenly compelled to provide for using a very large quantity of funds. The committee is aware that the step thus recommended is of fundamental importance and will produce an extensive transformation in present methods of national banking. It, however, believes that the effects of this transformation will be altogether beneficial and is confident that the conditions under which the change is to take place as provided in the new bill are such as to make the transfer not only without suffering to the banks but under conditions that will actually enable them to extend further loans to the community. The actual effects of the operation proposed have been worked out in some detail by the committee and are presented as a series of computations in connection with the section of the proposed bill which provides for the revision of reserve requirements. Final analysis of these figures may be deferred until that point. It is enough to say at this point that a sufficient amount of reserve has been released, as compared with present requirements, amply to provide for the actual transfer of funds called for by the bill at the outset of the new system. Subsequent transfers will amount only to about enough to place the new system upon the same basis as the old in the matter of reserve requirements, when a margin has been allowed for contributions of capital and for possible accessions of State banks to the system. Or, to sum up, the new system will require less cash than the present one in order to fulfill its reserve requirements and provide for the payment of capital subscriptions. The margin between present and proposed requirements which it is thought should be left in order that State banks may come into the system without causing any strain upon the cash resources of the country will probably be from \$100,000,000 to \$150,000,000, a sum which is believed to be ample. Needless to say, the new reserve requirements will not fall upon all banks in precisely the same way or with precisely the same degree of severity. In the case of some it may be that a transfer of cash to the new system will be undesirable. In such an event it is, of course, always open to the banks to establish their required reserve credit with the new Federal reserve banks by rediscounting paper with them. With the enormous resources that will belong to these reserve banks at the outset they will be amply able to take care of many times the amount of any such applications that are likely to be made to them.

RETIREMENT OF BOND-SECURED CURRENCY

There are several important reasons for the retirement of bond-secured currency. The most obvious is that bond-secured notes are not "elastic." By this is meant that the necessity of purchasing bonds to be deposited with a trustee for the protection of note issues prevents banks from issuing these notes as freely and promptly as they otherwise would, while it also prevents them from retiring or contracting the notes as freely and promptly as would otherwise be the case. There is little or no disagreement at present among students of the banking and currency problem in the United States that the retirement of the bond-secured notes is essentially necessary if success is to be had in restoring elasticity to the circulation and in making the national banking system really responsive to the needs of business. For that reason every plan of currency or banking reform that has been put forward during the past 15 years has contained as an important factor some provisions for getting rid of the bond-secured notes. The basic criticism on the present system of notes already indicated is reinforced by the fact that the supply of United States bonds available for use in protecting note issues is likely to be limited, as was the case in the panic of 1907. Then the national banks were not able to enlarge their issues because of their inability to obtain further bonds, until they had been aided by the action of the Government in issuing additional bonds for the very purpose of furnishing a backing for currency, notwithstanding that at that moment there was a very large surplus in the Treasury. Over and above this consideration has been the fact that the formalities and technicalities connected with the issue of bank notes based upon bonds have been so great and troublesome as to preclude the easy and prompt supplying of currency, even when there were enough bonds in the market to furnish all the backing for notes that might be desired. This shows why, apart from the special and peculiar difficulties that attend anything of the sort, the substitution of bonds other than national for the national bonds now used will not help the situation. The only way to relieve the bad conditions that have developed in connection with national-bank currency is, therefore, generally admitted to be the abandonment of the bond-security plan and the introduction of something else in its place.

DIFFICULTY OF BOND HOLDINGS

The first difficulty in passing from the bond-secured system of note issues to anything that might be devised to take its place is the fact that even if all had been satisfactorily arranged with reference

to the new system, its soundness, etc., the difficulty of dealing with the bonds would remain. The act of March 14, 1900, provided for refunding the outstanding bonds into the 2 per cent consolidated debt and these 2 per cent bonds were subsequently sold at premiums which once ran as high as 8 or 9 per cent and have regularly been 2 or 3 per cent or more. Primarily as a result of general depreciation in the values of bonds due to rising prices and higher interest for capital, the national bond quotations have sunk until the 2 per cents are now below par. The ownership of bonds has thus inflicted a severe loss upon holders already, and something like \$30,000,000 has, according to the Comptroller of the Currency, been "written off" by the banks and must be regarded as one of the costs of carrying the note system at present in use. There is general agreement that if the circulation privilege were to be taken from the 2 per cent bonds or, what is the same thing, if a new system of note issue were to be established which would practically displace the present system, the twos would deteriorate to a price not higher than 80. This would mean a shrinkage of one-fifth of the par value of the bonds and would inflict upon the banks an aggregate loss of nearly \$150,000,000. Alternative to this is the idea of providing for a refunding of the bonds. Experience, as well as computations made in the Treasury, indicate that 3 per cent is now about the level of the Government's present borrowing power. The \$50,000,000 Panama bonds last sold brought a premium of between 2 and 3 per cent, but 3 per cent interest without the circulation privilege represents the minimum interest that must be paid (in round numbers) upon any future issue which is to be floated upon an investment basis. In order to safeguard the banks against loss, therefore, a plan of refunding into 3 per cent bonds would have to be followed. The banks might be offered cash payment for their bonds at par, and the new securities might be sold for what they would bring, or an exchange of 3 per cents for the old twos might be ordered. The latter would be simpler, and the former would probably cost a little more. Either plan would entail an increase in the present interest burden nearly amounting to 1 per cent annually on at least \$740,000,000, or \$7,400,000 a year.

Temporary alternatives for the retirement of the bonds are, however, proposed here and there. The most familiar and perhaps the most available plan of the sort is that which proposes to require banks to have outstanding a certain percentage of notes based on bonds before they become eligible to take out notes without bond security. This would mean that an inflexible volume of bank notes was kept

outstanding, or at all events that an inflexible volume of bonds was held by the banks to protect such outstanding notes in case they should be issued, and that whatever new form of currency might be provided for would come out in excess of or in addition to the basic volume of notes and bonds already referred to. The plan would partially destroy the possibilities of elasticity in the note currency system, but at the same time it would operate to keep up the value of the existing bonds for the time being. The question would then be whether the effort to sustain the value of the bonds in this manner during the remainder of their life was not too great to be compensated for by the saving in interest thereby effected. The general opinion of students of the subject undoubtedly is that this temporary method of sustaining the value of the bonds is undesirable, and that it is far better to recognize the facts in the case and take up the securities in such a way as to relieve the banks from any danger of further loss, the Government bearing the increased interest charge and leaving the banks to turn in their securities at will.

What has been thus far said has been founded upon the assumption that agreement had been reached with reference to the method of note issue to be followed when once a plan for retiring the old notes and disposing of the bonds had been agreed upon. While no such agreement has ever been arrived at, it is true that substantial agreement has been reached with reference to the basis on which the notes which are to supersede national-bank issues shall be put out.

Another phase of the note-issue question is seen in connection with the problem by whom the notes should be issued. The current assumption is that in the event of the creation of any central or cooperative institution the note-issue power now exercised by the several banks should be transferred to and vested in this new organization. There has been a tendency to overestimate the importance of the note-issue function and to treat it as if it were the chief object to be attained in banking legislation. This idea may be attributable to the belief that "emergency currency" is what is needed in order to relieve panics and stringencies, whereas what is actually needed is fluid resources of some kind, whether notes or not. The belief that the notes are very important has also been stimulated by the experience in this country with clearing-house certificates, which are often spoken of as if they were notes. The fact is that they are merely evidences that the banks that have gone into the clearing-house arrangement are willing to accept a credit substitute for money in settling their balances with one another. It remains true that the provision of a satisfactory note currency

would be a long step in advance, as compared with existing conditions. With proper control and restriction it would, however, supply a means of obtaining additional circulating media in time of panic or stringency when there was a tendency to hoard money, and would to that extent relieve the danger of collapse due to inability to convert assets into fluid resources. It is therefore a cardinal element in currency and banking reform and should be provided for.

COMMITTEE'S NOTE PLAN

After reviewing all of the different factors in the situation, the Banking and Currency Committee has reached the conclusion that the issue of national-bank notes now current should, for the reasons already surveyed, be retired despite the serious difficulties that have been sketched, and that in their place a new issue of notes put out by the Government of the United States and closely controlled by it should be authorized. This issue of notes it is proposed to entitle "Federal reserve Treasury notes." In its essence the plan now recommended by the committee for a new note issue contains the following points:

- 1 Ultimate withdrawal of the circulation privilege from the Government bonds of all classes
- 2 Issue of notes by the Government through Federal reserve banks upon business paper held by such banks
- 3 Redemption of such notes and regulation of their amount outstanding at any moment through Federal reserve banks

The ultimate withdrawal of the circulation privilege means that some provision of proper character must be made for the existing bonds. It is suggested that, first of all, this should mean the payment of the bonds at maturity and a definite statement to that effect. This the committee has included in its bill. The bonds now have no due date, and while the Government may redeem them after 1930, they are not necessarily payable at that period. If the bonds are to be continued outstanding, it would seem to be an essential feature of their composition that they shall be allowed to retain the circulation privilege. To get rid of this, it is only necessary to declare them due and payable as soon as the Government has the right to apply that principle. But, in the second place, it would appear that the reform of the currency along the lines proposed, if it is ever to make a fair start, should proceed from the abolition of the circulation requirement in the case of banks either organized or to be organized. The committee has, therefore, proposed to repeal that provision of the existing law which requires the deposit of bonds by every bank in stated amounts. This

means that banks may, if they choose, entirely free themselves from circulation. In order to enable them to do this, and at the same time to supply the place of the small but steady demand for bonds which was afforded by the purchases made by newly organized banks, the committee proposes to allow a voluntary refunding process to be carried out over a period of 20 years at the rate of not to exceed one-twentieth of the circulation outstanding at the time of the passage of the act. It is probable that if this provision were fully availed of it would mean an annual refunding of 2 per cent bonds amounting to about \$37,500,000. In consideration of the action of the banks in surrendering the circulation privilege on the bonds which they thus voluntarily present for refunding, it is proposed to give the banks a 3 per cent bond without the circulation privilege. This is believed to be an excellent business policy for the Government, as it could scarcely borrow at a lower rate than 3 per cent to-day. What it will be able to do at the end of 20 years is entirely problematical, but it is a fact that the circulation privilege is worth at least 1 per cent, and in surrendering it the banks get no undue consideration from the Government. They do, however, materially facilitate the process of converting the old national-bank notes into the proposed new issue of Federal reserve Treasury notes.

COST TO THE GOVERNMENT

That the cost to the Government of this conversion will be 1 per cent on the amount converted, or in the last analysis very near \$7,500,000, if all the bonds should thus be surrendered is obvious, but it is also clear that the change would, for reasons stated, be an excellent investment for the Government. The committee has arranged to give the proposed Federal reserve board power to tax the new currency at such rate as it might deem best, and should it impose a tax of 1 per cent the Government would be reimbursed for any excess interest payments which it might be required to make on the new bonds. Over and above this plan of recouping itself for any losses is the fact that the Government is to receive a substantial share of the earnings of the proposed institutions of rediscount. If the plan of the committee should be accepted and carried through in complete form, the result would be a profitable one for the Government.

Whatever may be the ultimate earnings of the banks, however, the committee is convinced that the conversion of the bonds and the retirement of the present notes, followed by the issue of new notes, ought to be effected at all hazards and at any cost, as a fundamentally desir-

able public reform. It believes that the change should be carried through upon a frank, open, and direct basis, and that no effort should be made to mask, as was done in the Aldrich bill, proposed by the Monetary Commission, the real nature of the process or the burden and distribution of its cost.

The committee is of the opinion that in order to have the new currency at once satisfactory and effective, it must be (a) sound and (b) elastic. The soundness of the new notes will, in its judgment, be amply secured by the fact that they are made obligations of the Government and a first lien on the assets of the Federal reserve banks issuing them, while they have also been immediately protected by the hypothecation of first-class commercial paper in the hands of an agent of the Federal reserve board at each of the banks. Their elasticity depends entirely upon two fundamental elements—(1) the provision of an adequate money fund for their redemption and (2) provision for the prompt presentation of the notes. The money fund is provided by the requirement that no notes shall be issued by a Federal reserve bank unless $33\frac{1}{3}$ per cent of money shall have been segregated in the vaults of the issuing institution for the purpose of paying such notes upon presentation by any holders. The banks are left to provide this fund, and are both vested with the duty and equipped with the power to obtain it and hold it, either by withdrawing it from domestic channels or importing it. They are required to redeem the Federal reserve Treasury notes, both of their own issue and those issued by other Federal reserve banks, whenever the notes may be presented to them from any source, while, as a central point of redemption, it is provided that the Treasury Department shall pay the notes out of a fund of money (constituting part of the $33\frac{1}{3}$ per cent referred to) which shall be placed in their hands by the several banks. This means that the Federal reserve Treasury notes will be redeemable in money at each of the 12 banks and at the Treasury, while the requirement that the notes shall be payable to the Government and to any bank for deposit purposes will be tantamount to a quasi-redemption at every point where banking is carried on. In order to insure the prompt presentation of the notes for redemption, thereby avoiding danger that they may accumulate in the bank vaults, the bill refuses to authorize their use as reserve money by member banks, while of course they will be excluded from the reserves of Federal reserve banks.

Provision is also made whereby they will be prevented from accumulating in the Treasury or any of its subtreasuries even in small quantities. It is believed that these provisions will insure the prompt

return of the notes, thereby producing genuine flexibility in the currency. The notes will be taken out whenever business paper eligible for presentation to Federal reserve banks for rediscount is created, and as such paper matures, is paid off, and shrinks in volume the basis for the notes will correspondingly shrink, and either the notes themselves or an equivalent amount of lawful money will be withdrawn from circulation. It is an undoubted feature of the measure as now drafted that it will furnish an ample mechanism for insuring the cancellation of the notes as well as for their issuance. While this process is going on, there will have been an active redemption of the notes, owing to the operation of the provisions for exchanging them for money already sketched.

USE OF GOVERNMENT FUNDS

One feature of the proposals for legislation contained in the committee's bill is the recommendation that the funds of the Government of the United States received by it as a result of current business transactions and heretofore held in the Treasury shall thenceforward be deposited with the Federal reserve banks, the latter institutions to act as fiscal agents for the Government in all of its transactions thenceforward. This recommendation is of fundamental importance. The Independent Treasury system of the United States under which the Treasury Department now carries on its operations dates from 1846 and is the result of the legislation then urged and adopted for the purpose of putting the country upon a so-called hard-money basis. Whatever may be thought of the idea of actual specie payments and of segregation of Government cash, both when it comes into and when it goes out of the Department of the Treasury, experience has shown that the system is not feasible. It was necessary to suspend the Independent Treasury system, practically speaking, when the Civil War broke out, and upon every subsequent occasion of stress or difficulty in the market a repetition of this suspension has become practically unavoidable. It has been necessary on those occasions to redeposit the funds of the Government in banks in order that the commercial community need not be deprived of the use of them even for a short time. At times it has been found expedient, if not absolutely necessary, to temporize with the law and with the technical requirements of the Treasury system, and practically to abandon the plan of requiring cash payments even when that was theoretically lived up to—thus again in order to avoid any withdrawal of urgently needed funds from the business community.

In normal times the withdrawal of these funds has, of course, been far less noticeable in its influence upon the business world, although at all times it has been a fact that the withdrawals did disturb in a measure the natural balance and distribution of funds between different parts of the country and did thereby tend to embarrass some parts of the country much more than others, owing to the fact that withdrawals of cash due to the payment of taxes were neither identical in amount nor proportionate in importance in these several sections. The inadequacy of the Independent Treasury system and of the present method of making public deposits has indeed been fully recognized by Congress when it provided that all such deposits in banks should be made only upon security of United States bonds, a requirement which means, if it means anything, that the banks called national and under congressional supervision, although deemed safe enough for the use of the public, are not safe enough to serve as depositaries of public funds—a situation which, if actually what it seems to be, is both ridiculous and disgraceful. This condition of affairs would, however, be greatly aggravated and would become even more anomalous if Congress were to authorize the creation of a new set of banks intrusted with the power of holding reserves and acting as the intermediaries through which a new currency is issued, yet unable to be trusted as custodians of Government funds. Both for economic reasons and because of considerations of the logic and dignity of the situation, it is desirable to have the current receipts of the Government deposited in the new banks and its disbursements made by drawing upon these institutions. The Treasury is in no way interfered with by this process save in so far as it is relieved of some routine duty. It is left to manage the fiscal affairs of the Government in precisely the way that is now practiced, but the actual funds are placed with the Federal reserve banks, where they will continue to be available for the banking needs of the community which created them and which is responsible for the solvency and activity of the business processes that afford the basis of taxation and thereby supply the fundamental resources of the public Treasury.

BENEFIT FROM DEPOSITS

Too much can not be said of the benefit that will be derived from the continuous depositing and withdrawing of public moneys through the Federal reserve banks, as compared with the present artificial system of periodically contracting currency through heavy withdrawals due to large payments for customs and internal revenue and of period-

ically expanding the currency through deposits in the banks, which, however wisely selected can never restore the funds to exactly the same channels from which they were drawn. A very large share of responsibility for the past panics and crises of the United States must undoubtedly be assigned to the Treasury system which has been responsible for this sporadic and spasmodic movement of funds. In unskilled or selfish hands, the power thus bestowed upon the executive branch of the Government may be, as it has at times become, most dangerous to the public welfare, while it is always a source of grave responsibility and danger scarcely to be overestimated in its importance. The usual consideration against placing Government funds in the banks has been that by so doing certain banks were favored at the expense of others while the Government was deprived of its legitimate return upon the moneys that it furnished. Under the proposed plan, no such danger exists. Power is given to the Federal reserve board and to the Secretary of the Treasury, jointly, to establish a rate of interest upon public deposits, thereby rendering it possible for the Government, if it chooses, to assure itself a fair adequate return for its funds from the very time that they are placed in the banks. Under the section of the proposed bill which provides for a distribution of earnings the Government of the United States is given 60 per cent of all net income after the banks have received 5 per cent upon their invested capital. The Government is therefore in position to get its full and due return for every dollar that it places in the hands of the banks, while the community has the use of the money thus left subject to the disposal of trade and commerce according to their necessities. This is as it should be, since it amply protects the Government, safeguards the public interest, and assures the returns of the profits from the use of the funds to the Government after the banks have received the fair going rate of return for carrying on their business and performing the routine operations connected with their duties as fiscal agents of the Treasury.

There is another aspect of this Treasury deposits system that deserves mention in this connection. The bill provides for the depositing of funds not in any one bank, and not in accordance with any system that would place the moneys in any particular group of banks, but for the depositing of the funds in such banks as from time to time may be deemed wise, having due regard to an equitable distribution of these moneys among the different sections of the country. The power is, however, retained to make redistribution whenever deemed best, and this means that the provision is important as an adjunct to the

power of the Federal reserve board over rediscounts and rates of interest as well as over reserves

EQUALIZING RESERVE FUNDS

It is evident that the Federal reserve board and the Secretary of the Treasury could, by shifting the deposits of the Government from place to place as occasion demanded, meet conditions of stringency and difficulty in the market, or furnish exchange funds as occasion appeared to require. The power would naturally be exerted before any resort was had to any method of interfering with the loans of the banks or with their reserves, and would of course be far more satisfactory as a means of equalizing resources than the exercise of the compulsory rediscount power. What has been done by various Secretaries of the Treasury in times past, and has been successfully done, toward the readjustment of banking accommodations, by the making and withdrawal of public deposits in different parts of the country, with comparatively meager funds, under the present Treasury system, gives a faint suggestion of what might be accomplished in the way just indicated. We have stated that in our judgment the use of the Treasury funds for deposit purposes in the manner referred to has never been desirable and has frequently resulted in leading, through long-continued employment, to panic or to artificial and injurious conditions of various kinds. What has just been said does not in the least weaken the force of the general observation thus restated. The harm resulting from past efforts of this kind has arisen primarily from the fact that they were necessarily carried out without intimate knowledge of or close association with the banking mechanism of the country.

The evil which came from these efforts was due to the lack of adaptation to existing conditions. Under the proposed plan the funds of the Government will never be removed from the uses of the commercial community, but they will continue in the general regions of the country where they originated, while those who are to be charged with the duty of overseeing the management of Government funds will have at their disposal the information that is needed to enable them to readjust deposits or to grant temporary relief through the shifting of Government resources should conditions suddenly require action of that kind. The situation will not only be such as will put an end to the vicious and wholly artificial state of things existing under the present type of Treasury organization, but will substitute for it a helpful system whereby definite governmental authority, closely informed concerning banking conditions and constantly in touch with

the development of credit in all parts of the country, will be in control of an enormous mass of fluid resources which it can transfer by normal methods through the ordinary channels of trade from one part of the country to another, as conditions warrant, or, better still, can direct the flow of this mass of resources now here and now there, as circumstances call for it. The process will be conducted with knowledge of the highest order and will be free of the difficulties which have heretofore beset the making of Treasury deposits. It will be similar in operation to the function that is performed by the central banking institutions of foreign countries and will be carried out by exactly similar methods save that, because the authorities in charge of it are not hampered by commercial motives and are not interested more in one part of the country than in another, they will be able to do the work without any of the interfering considerations of private profit which frequently prevent the operations of a central banking institution from being carried on solely in the public interest. In the best sense of the word, the Government will be completely "out of the banking business" and in the best and proper sense of the word it will be in that business, neither under the necessity of interfering with normal trade operations nor of artificially interposing to bolster up weak banks in any part of the country.

BANKING FACILITIES FOR FOREIGN TRADE

It has long been a ground of complaint that the national banking system provided no adequate means for the establishment of American banks in foreign countries. This criticism has had some warrant, and in view of the rapidly expanding foreign trade of the United States it is deemed wise to make proper provision for banking machinery in foreign countries which shall be closely controlled by home institutions. The bill proposed by the National Monetary Commission sought to accomplish this end by providing for the creation of a special type of institutions to be organized by national banks as stockholders and to engage in operations abroad. The committee is of the opinion that no such elaborate mechanism is necessary, but that every good purpose of the monetary commission plan can be attained by the adoption of the plan it has proposed, which consists essentially of provision for the establishment of foreign branches by existing national banks when such banks have an adequate capital for the kind of work in which they propose to engage and are found by the Federal reserve board to be in proper condition for undertaking such an enterprise. The proposed plan is simple and, it is believed, sufficiently effective for

the purpose Under it national banking institutions will be in position to create branch offices at such foreign points as they may deem best, assigning to them a due share of capital and conducting their affairs separate from those of the home office in order that there may be no difficulty in ascertaining at any moment the distribution of the business of the institution It is believed that with the extension of national-bank powers which is provided for in the present act, such branches of national banks would be amply able to meet the requirements of their clientele wherever it might be necessary for them to operate

APPENDIX TO CHAPTER XIV

LETTER OF SECRETARY BRYAN TO REPRESENTATIVE GLASS CONCERNING INTERLOCKING DIRECTORATES

Department of State
Washington

August 22, 1913.

Honorable Carter Glass,
House of Representatives,
Washington

My dear Mr Glass —

Replying to your inquiry, I beg to say that I have for many years advocated a law preventing the duplicating of directorates While the principle applies to banks as well as to trusts—although, I think, in a less degree—the plan has been considered mainly as a means of dealing with the trust evil—in fact, it is a part of the anti-trust plank of the Baltimore platform Competition can be effectively prevented where the same men act as directors of competing companies. I am as much in favor of the remedy now as I was when I began to advocate it, in fact, more so, because recent disclosures have given further proof of the employment of this means of eliminating competition, but I do not think it wise to make it a part of the pending currency bill. In attempting to secure remedial legislation, care must be taken not to overload a good measure with amendments, however good those amendments may be in themselves. A boat may be sunk if you attempt to make it carry too much, however valuable the merchandise. A bill is usually the result of compromise, the President and Secretary McAdoo, in conjunction with the Chairmen of the Currency Committees of the House and Senate, have formulated a tentative measure. It was prepared after extended investigation and a comparison of views. It embodies certain provisions of great importance and is, I believe,

fundamentally sound. The provision in regard to the Government issue of the notes to be loaned to the banks is the first triumph of the people in connection with currency legislation in a generation. It is hard to over-estimate the value of this feature of the bill. In the second place, the bill provides for Government control of the issue of this money—that is, control through a board composed of Government officials selected by the President with the approval of the Senate. This is another distinct triumph for the people, one without which the Government issue of the money would be largely a barren victory. The third provision in this bill which I regard as of the first importance is the one permitting state banks to share with national banks the advantages of the currency system proposed.

These three provisions are, to my mind, of such transcendent importance that I am relatively but little concerned as to the details of the bill. I do not mean to say that the details are unimportant, but whatever mistakes may be made in detail can be corrected easily and soon—a wrong step in a matter of principle would be more difficult to retrace. There are doubtless differences of opinion over matters of detail, and it was to adjust these that the caucus was held, but I take it for granted that no one who is really in favor of the bill will permit a difference of opinion on a matter of detail to lead him to jeopardize the bill.

The papers have in a few cases reported Members of Congress as presenting views which were alleged to be mine. I do not know to what extent these reports may exaggerate what has been said and done but you are authorized to speak for me and say that I appreciate so profoundly the services rendered by the President to the people in the stand that he has taken on the fundamental principles involved, that I am with him on all the details. If my opinion has influence with any one who is called upon to act on this measure, I am willing to assume full responsibility for what I do when I advise him to stand by the President and assist in securing the passage of this measure at the earliest possible moment. I am sure that the President will be ready to join in making any change in detail that can be made to advantage, and being sure of his singleness of purpose, I am willing to leave to future action the correction of any provision which he may now regard as essential to the plan and purpose of the bill.

Congratulating you upon the splendid manner in which you have presented the merits of this bill, I am

Very truly yours,
(Signed) W. J. BRYAN.

CHAPTER XV

THE PROVISIONS OF THE FEDERAL RESERVE ACT

General Status of Bill

The Federal Reserve Act in the form in which it was placed before the House of Representatives may be regarded as the first definite draft of the measure and as such is entitled to careful analysis. It would be worthy such analysis in any case, but specially careful scrutiny is worth while in view of the misunderstandings and even misrepresentations which have centered around the subsequent history of the measure.

Such misunderstandings relate not only to the content of the original measure itself but also to the question whether the act was or was not materially modified by the Senate Committee on Banking and Currency, by the Senate itself, or by the later conference committee between the two Houses. In the Appendix to the present volume it has been thought wise to collect several of the principal drafts of the measure in order that there may be no question on this point. Comparison of them, however, involves detailed and painstaking study if their essential features are to be thoroughly understood. It is thought best to present herewith as a part of the treatment, therefore, a general outline analysis of the content of the Reserve Act in the form in which it had been passed upon by the House Committee on Banking and Currency, and to make later references to such changes as may have been introduced in the text, employing the analysis of this chapter as a basis of comparison, thus avoiding the necessity of more lengthy explanations and repetitions at later points in the volume. In

preparing this chapter the House Committee's report on the Federal Reserve Act,¹ which was originally written by the author and published as thus prepared, has been used nearly verbatim as the basis of description

SECTION 1

Section 1 created a short title which may be used for convenience' sake in the future in referring to the act. It needs no discussion.

SECTION 2

Section 2 provided for the districting of the country and for the organization of a reserve bank in each such district. These two topics may be discussed separately, it being prefaced that the purpose of the proposed bill is to substitute for the national currency associations of the Aldrich-Vreeland law a series of reserve banks to be organized in independent districts and to do in a better and more continuous way the services which had been expected of the currency associations themselves.

It has been explained that the purpose of any thorough banking legislation must necessarily be the creation of a means for rediscounting existing paper and for furnishing either a bank credit or an elastic and reliable bank-note issue as the medium by which such discounts may be afforded. Without going more into the theory of this proposition, already thoroughly well covered, it may be stated that the medium through which the bill proposed to attain these ends is the organization of a reserve bank to be entitled a "Federal reserve bank" in each one of the Federal reserve districts to be established as provided in section 2. In briefest terms, then the reserve bank in each district will do for existing banks what an ordinary bank does for its customers, that is to say, it will hold their surplus funds, furnish them loans, offset their payments and receipts, and supply them with the means of making remittances. In broad theory there will be no difference between the services performed by the reserve banks or bank and those performed by the existing banks for individual customers. Unless it be true that the reserve banks are granted some special privilege or relationship to the Government there will be no reason why they should not be organized upon the same basis and for the same general purposes as existing banks. Indeed, with one or two minor modifications of existing law they could be so organized under the

¹ H. R. Report 69, 63rd Congress, 1st Session

present national bank act It is to be noted that some national banks now organized and doing business in the larger cities perform in a measure very much the same functions for smaller banks which do business with them that it is now proposed to have the reserve banks to be organized under this act do for the banks that are to be their constituent stockholders The existing banks which perform this function do it for profit, and when opportunity offers make exorbitant returns for themselves on the transactions they enter into The proposed reserve banks are to be cooperative institutions, rendering their service for the good of all the banks that are stockholders in them, as well as for that of the public, while the Government is to get the excess profits of the institutions The detailed functions of the reserve banks can be best brought out in connection with subsequent sections, where they are dealt with more elaborately

It is evident that before the different banks can be organized and placed it must be decided where they are to be placed and how large are to be the districts in which they shall operate For reasons which are already partly apparent and will be made more so as the discussion goes on, one such bank in a district is all that is needed or could profitably or properly be organized there This necessitates care in choosing the locations and fixing the size of the districts Two fundamental considerations are sought in performing this work

1 To provide each section of the country that constitutes a geographical and business unit with a reserve bank to serve its local banks and hold their reserves, making the districts sufficiently numerous to enable each such section to feel that its wants are met by its own local reserve institution under its own control At the same time it is recognized that the districts should not be made so small as to cut the capital of the reserve institutions to a figure that would make them weak

2 To see to it that reserve banks are given a capitalization that will enable them to do what they are designed to do and are so situated as to avoid any shock to business enterprise resulting from the shifting of bank reserves from existing banks to the new reserve banks in the way outlined in the present bill

It is believed that the fixing of the exact number of banks and the delimitation of the districts are points that can only be exactly met after careful investigation by a properly qualified body appointed for that purpose It has, however, been thought wise to fix the minimum number of such banks to be established in order that in passing the law the community may be assured of adequate provision for its needs.

It is proper to say frankly that much difference of opinion as to the number of such banks has been expressed, some placing the desired number as high as 50, others as low as 3. Those who advocate the larger number think that there should be one such bank in practically every reserve city, on the ground that the reserve cities of the present day owe their existence to a definite need which has resulted in their establishment, and that this need ought to be recognized under such legislation as may be passed. Those who advocate the smaller number think that the banks should be created in central reserve cities only. They say that these central reserve cities are now the ultimate holders of reserves and that if they alone had the reserve banks proposed to be organized under this act there would be very little friction or difficulty in passing from the existing régime to the proposed plan.

The Committee on Banking and Currency finds itself unable to side with either of these groups of thinkers. It believes that the number of reserve banks to be created ought to be large enough to meet the reasonable needs of the country and should not be so small as to play into the hands of those who want to establish a very high degree of centralization. It also thinks that the reserve banks should be few enough in number to make them really independent institutions, likely to look to one another for aid only under emergency conditions, and hence not in danger of being controlled by other reserve banks. It has therefore fixed the minimum number of reserve banks at 12. This number has however not been arrived at from theoretical considerations solely, but also as a result of the following data.

1 The committee has asked a considerable number of bankers their views as to the proper number of such institutions. Many of these bankers were questioned during the hearings of last winter. Among them were Messrs. A. B. Hepburn, who thought that if such a plan were adopted the number should be one in each clearing-house district (hearings, p. 10), Sol. Wexler, who thought that the number should be about 15 (hearings, p. 623), Victor Morawetz, who fixed the number at 1 in each clearing-house district (hearings, p. 48), Sir Edmund Walker, who thought the number might run as high as 20 (hearings, p. 666), and others. Mr. J. V. Farwell, a well-known merchant of Chicago, suggested 5 to 7 as the number (hearings, p. 452).

2 Experience under the Aldrich-Vreeland law has resulted in the organization of 18 currency associations.

3 The Aldrich bill, so called, or National Monetary Commission bill, provided for a central reserve association with 15 branches or 16 banking institutions, open to the banking public, in all.

4 Examination of the present bank capital of the country shows that the number of banks on the basis of capital contribution could not well be in excess of 12 or 15 if the capitalization of the reserve banks themselves was to be sufficiently strong to make them effective. Assuming that the total capital of the national banks to-day is somewhat over \$1,000,000,000, and assuming further that State banks possessing a capitalization of one-half that amount were admitted to the proposed institutions, it might be estimated that these Federal reserve banks would be owned by banks with an aggregate capitalization of \$1,500,000,000. It will be shown later in the present discussion that the capitalization contribution to be exacted of each bank is 10 per cent of its present capital. That would make a total capitalization for the proposed reserve institutions of \$150,000,000. Assuming that this amount was contributed and that there were 12 such institutions, their average capitalization would be \$12,500,000, which is believed to be ample to meet the needs of the communities represented. If it should be roughly assumed that one-third of the proposed banks would be near the lower limit of \$5,000,000 capitalization, this might mean five reserve banks with a gross capitalization of \$25,000,000, five reserve banks with an average capitalization of, say, \$7,500,000 and a gross of about \$37,500,000, so that there would be left five with a gross capitalization of \$87,500,000, or an average of \$17,500,000. It is probable that as New York City already possesses two banks of \$25,000,000 capital each, while her banking resources are very large otherwise, the bank of the New York district might be given a capitalization of \$30,000,000 or \$35,000,000, in which case the other four banks belonging to the group of large institutions might have an average capitalization of \$13,000,000 apiece. These figures are all purely tentative and are merely intended to represent the way in which the districting might operate. Further attention can be given to the subject of districting and its effect upon the banks in connection with the study of the reserve section of the bill, which will be taken up somewhat later in this discussion. It is undoubtedly true that the proposal to create as many as 12 reserve banks will receive very sharp criticism from banking interests which are desirous that there shall be as high a degree of centralization as possible in the new system, while it is also thought probable that the proposed number will be sharply attacked by others who think that the 12 is by no means enough to give all portions of the country a chance to be fairly represented and adequately heard in connection with the rediscounting of paper. The figure fixed has, however, been the result of careful

study and the committee feels entire confidence in its approximate correctness. It recognizes that in the future as the country grows there will be need of an increasing number of reserve banks, and therefore the power is given to create more such banks in the future as occasion requires.

Inasmuch as no machinery is in existence for the creation of such banks, and inasmuch as the process of districting the country can not be described in any hard and fast manner, it has been deemed best to leave this analysis of business conditions for which there are at present no adequate statistics within reach, to a committee including the Secretary of the Treasury, the Attorney General, and the Comptroller of the Currency. In order that they may do their work correctly and successfully it will be necessary for them to ascertain with care the business connections of each of the principal cities of the country in order that the districts in which such cities are located may be properly shaped in a way that will not alter the present course of exchange and interbank remittances. The task thus prescribed may be one of some considerable length, and therefore it has been deemed best to leave the establishment of the details and the fixing of dates for organization to the judgment of the committee in question, subject only to the provision that in general it shall be completed within a reasonable time. Inasmuch as the work of making the distribution and apportionment of banks by districts will involve some expense, it is proposed to assign a moderate sum to cover the cost of travel, employment of expert assistance, etc.

SECTION 3

Section 3 relates to stock issues, and divides the share capital into shares of \$100. This unit is adopted because it corresponds to the unit of share capital in the national banking system, and is therefore an easy basis for computation of the share capital which a given bank will be required under the act to take out. The fact that it has been determined to have the share capital of the Federal reserve banks bear a fixed relationship to and be subscribed by the existing banks of the country makes it necessary to provide some means of recognizing the growth of the system or its shrinkage, as the case may be. The second clause of section 3, therefore, calls for the increase of the capital stock of the Federal reserve bank according as the amount of capital in the system increases and is decreased by a converse process. This means that no Federal reserve bank would ever have a fixed capital, since that capital might easily change almost from day to day.

The fact remains that the capital would be a fixed percentage of that held by the member banks, while in view of the later provisions of the act it is believed that the amount of this capital could be easily ascertained at any moment and the payments to withdrawing banks be made without any serious difficulty.

A second feature of section 3 is the provision that each Federal reserve bank may establish branch offices subject to the regulations of the Federal reserve board not to exceed one for each \$500,000 capital of the stock of each Federal reserve bank. After due study it has been required that such branches should be established only in the district in which the Federal reserve bank is located. Branches of different Federal reserve banks will, therefore, not compete with one another, but will be simply offices established for the convenience of the member banks, facilitating their relations with the Federal reserve bank in which they are stockholders. The question may fairly be raised whether a Federal reserve bank should be allowed to establish one office in each of the other Federal reserve districts should it so desire, but after due consideration it has not been deemed desirable to permit such an extension of the power to create branches.

SECTION 4

Section 4 provides for the incorporation and organization of the Federal reserve banks under the conditions already outlined in the preceding section. Fundamentally the purpose of the section is to authorize the incorporation of such a reserve bank in each district with powers precisely analogous to those of national banks except in so far as altered by the act itself. The organization, officers, and the like of the reserve banks will under the terms of this section be the same as those of the national institutions. There is no reason why any important distinction as to type of organization should be drawn or exist between the typical reserve bank and the typical national bank. This is worthy of special note because of the claim that Federal reserve agents, whose functions will presently be described, would practically be the active managers of the reserve banks. They would in fact be chairmen of the boards of directors, but as in the case of national banks such a chairmanship might be more or less active, according as the bank itself chose to determine.

The first clause of section 4 provides that a "sufficient number" of banks having made and filed with the comptroller a certificate, etc., shall thereupon be organized. As was provided in section 2, the minimum capital of a reserve bank is to be \$5,000,000, so that the

sufficient number referred to would mean in practice banks having a joint capitalization of at least \$50,000,000. The sections of the national banking act referred to as defining the powers of the banks in question are those which state generally the limitations upon the functions of national banks and the rights and authority vested in them. The final provision of the first paragraph of the section giving to the Federal reserve bank a charter life of 20 years is the same as the corresponding provision of the national bank act. The power of Congress to dissolve the bank at an earlier date if desired is likewise identical with the power reserved to Congress in national banks.

In dealing with the organization of the reserve banks the bill proposed by the committee has sought in section 4 to furnish a democratic representation of the several institutions which are members and stockholders of a reserve bank. To this end, the directorate is divided into three classes, each consisting of three members, while the stockholder banks are similarly divided into three groups or classes. The bill provides that the election of one member of class A and one member of class B shall be intrusted to each one of the groups into which the stockholding banks are subdivided. As it is required that each of the banking groups thus created shall contain approximately one-third of the number of banks in the district, it is clear that the banks comprising one-third of such capitalization would have a representative of their own in class A and also in class B. It might well be that the one-third in any given district would include a very small number of banks and that the director in question would thus be the representative of but few institutions. This, however, is deemed far better than to permit of the general choice of directors by all banks voting indiscriminately, it being the belief of the committee that by the method proposed each group of banks will preserve its autonomy and secure due hearing on the board of directors.

SECTION 5

Section 5 deals entirely with the method of increasing and decreasing the capital stock of Federal reserve banks and the effect thereon of corresponding changes in the stock of member banks. The general purpose is to require member banks to pay additional pro rata subscriptions as they increase their capital stock and to permit them to withdraw capital subscriptions in the same manner as they reduce their capital, or, in case they go out of business entirely through failure or liquidation to permit them to withdraw the cash paid in, assuming, of course, that there has been no loss sufficient to impair the capital of

the reserve bank Should such a loss occur the reserve bank would presumably have called sufficient of the unpaid subscriptions to restore its capital to the original amount, in which case the withdrawal of a sum equal to the original cash paid subscription would simply give the bank what it put in in the first place, the loss meanwhile having been borne by its contribution made on call The prohibition upon the transfer or hypothecation of shares in a Federal reserve bank, is of course, necessary in order to prevent the reserve bank from ceasing to be a democratic organization composed of members contributing in a like pro rata proportion of their actual available cash resources Any other plan might result in the concentration of share ownership in a few hands The intent of the bill is to have all banks vote alike at elections and as a preliminary requirement to enforce the retention of equal percentage of capital by each in the business of Federal reserve banks

SECTION 6

Section 6 is complementary to section 5 and merely provides for the treatment of the stock of Federal reserve banks belonging to member banks which become insolvent The fundamental idea in it is that of intrusting the Federal reserve bank with the function in the case of failure of deducting from the original amount of the failed bank's subscriptions any debts or claims due from said insolvent bank to the reserve bank and paying the rest to the receiver of the failed bank This, in effect, gives the reserve bank a prior lien upon the assets of a failed member bank up to the amount of its cash-paid subscription, which of course is a carrying out of the principle involved in requiring the member banks to subscribe 20 per cent, although they pay up but 10 per cent of their cash capital as a contribution to the stock of the Federal reserve bank of which they are members

SECTION 7

In section 7 it is provided that the division of earnings of Federal reserve banks shall be such as to give to the Government a due share of the proceeds of the banking operation after what is considered a fair remuneration for Federal reserve banks themselves has been provided It is also sought to devote the share of earnings going to the Government to the reduction of the public debt In general the process of dividing the earnings is divisible into three stages under this section:

(a) The first step in the process of dividing the proceeds of the banking operation is that of giving to the subscribing banks which

own the stock of the Federal reserve banks a due return for the use of their funds. This, after due consideration, has been fixed at 5 per cent—a rate of dividend which however, is to be cumulative. This should not be confused, as has been done by some critics of the proposed bill with a rate of 5 per cent from the capital of the banks. The banks, of course, will not set aside a part of their capital for this subscription but will devote a part of their current funds to it. The real question then is whether the rate of 5 per cent represents about the normal rate of return from current bank investments. Considering the high character of the security offered we are of the opinion that it does do so.

(b) The second step in disposing of the earnings is that of the accumulation of the surplus. While it is not supposed that the Federal reserve banks will incur severe losses, on account of their conservative nature and the auspices under which they are to be carried on, it is believed that the accumulation of a surplus to furnish an increased source of banking capital for the reserve banks, and so far as practicable to obviate any necessity of calling for any of the unpaid balances of the original capital subscriptions is highly desirable. One half of all net earnings after attending to the claims of the 5 per cent cumulative dividend is therefore to be devoted to the surplus until the said surplus amounts to 20 per cent of the capital of the bank. The remaining one-half is to be divided in the proportion of three-fifths to the Government and two-fifths to the bank's stockholders in the ratio of their average balances with the Federal reserve bank for the preceding year. It will be observed that this introduces a new principle of distribution of earnings not based upon relative ownership of capital stock. More will be said of this point very shortly.

(c) The third and final step in disposing of the earnings relates to the distribution after surplus has been fully provided for. Section 7 would give three-fifths of all earnings after the surplus is taken care of to the Government and two-fifths to the member banks in proportion to their annual average balances as before.

It is worth while to consider with some care what this plan of distribution would signify. Assume for the sake of argument that the rate of earning of the Federal reserve banks is about identical with that reported by the comptroller for the national banks of the country, or, roughly, 9 per cent. Taking 9 per cent as the figure, this would mean that with a total capital of \$100,000,000 the earnings for the first year would be \$9,000,000. Of this sum, \$5,000,000 would be required for the dividend requirements. This would leave \$4,000,000, of which

\$2,000,000 would be carried to surplus and the remaining \$2,000,000 would be divided as aforesaid in the proportion of \$1,200,000 for the Government and \$800,000 for the stockholding banks. It is, of course, impossible to state exactly how the division between the stockholding banks would finally turn out, since it can not be definitely stated what balances they would carry with the reserve banks.

THE GOVERNMENT'S SHARE

It has frequently been asked why the Government should be allowed to share in the earnings of Federal reserve banks at all. There are two reasons of conspicuous and obvious character why it should do so. (1) It vests the Federal reserve banks with the sole and exclusive function of note lending, from which all other banks are debarred, (2) it places the public funds with the Federal reserve banks to an amount certainly vastly larger than that of any other depositor and equal to the combined deposits of large groups of banks. The distribution of earnings upon the basis of deposit balances would give to the Government a large share of the profits in any case and when the present national-bank notes shall have been replaced by Federal reserve notes it is obvious that the function of note issue will result in a large volume of earnings which the Federal reserve banks could not enjoy were they to share this power with other banking institutions. To a substantial share in this earning, leaving for the reserve banks only a fair compensation for their services in taking out the notes, the public is evidently entitled.

The provision that the earnings of Federal reserve banks in so far as paid to the Government shall be regularly devoted to the reduction of the bonded indebtedness of the United States is manifestly a proper use of the income in view of the fact that the Government has incurred an additional interest charge upon its outstanding bonds for the purpose of persuading the banks to surrender their twos from time to time or at the end of 20 years for the purpose of converting the twos. By gradually applying the earnings received by the Government to the reduction of the outstanding bonds, selecting those that are available for circulation, it will be possible to maintain a moderate market demand for the bonds and at the same time to effect a gradual reduction of the outstanding indebtedness as well as, of course, a corresponding reduction of interest charges thereon.

Attention should also be given to the provision exempting Federal reserve banks and the stock held therein by member banks from all classes of taxation, save such taxation as may be imposed upon the

real estate held by these banks. In view of the increasing burden of taxation and of the Federal income-tax law, which now furnishes an additional draft upon net earnings, this exemption is likely to prove of material importance, since it amounts to an exemption of a corresponding proportion of the funds of member banks from the payment of taxes to which they would otherwise be subjected.

SECTION 8

The essential features of section 8 are

- 1 The grant of a year's time within which existing national banks may make up their minds whether or not to take out stock in Federal reserve banks under the provisions of the proposed bill, and
- 2 The provision that in the event of an adverse decision on this subject such national banks as may reach a decision of that character shall be dissolved the remedies now provided by law against such a dissolved bank shall not be impaired.

This in effect means that every national bank now in existence must within a year either (a) take out stock in a Federal reserve bank, (b) become a State bank under State laws, or (c) leave the business entirely. It is evident that any measure of legislation which imposes substantial responsibilities and burdens upon banks will be opposed by some of them, and that unless they are required to assume their duties to the community, they will if they are permitted to make a voluntary choice between their present condition and that proposed for them, elect to continue as at present. No matter how advantageous a plan proposed by Congress might be, many banks would refuse to go into it out of sheer inertia. This was the condition of affairs found by experience to exist at the time when the national banking act was first adopted, and it will be repeated to-day if the whole matter of assuming the new responsibilities prescribed by law is left optional with the banks. In view of the fact that the banks have their own remedy in their own hands, in that they may recharter under State laws if they desire, the measure recommended in section 8 is deemed entirely proper, not to say indispensable. The committee does not believe that it is the province of Congress to bribe or induce the banks to enter the new system, but rather to lay down equitable conditions and then to require their acceptance.

QUESTION OF "COMPULSION"

Much has been said by opponents of the proposed bill with reference to the question of what they call "compulsion." By this is meant

the requirement of the bill that national banks shall subscribe to the stock of the Federal reserve banks of the districts in which they are situated, or if they do not choose to do so shall leave the national banking system by surrendering their charters. A few persons have been disposed to contend that there was some illegality or "unconstitutionality" in this section of the measure—a claim which is readily dispelled by referring to existing legislation bearing upon the power of Congress regarding the amendment or repeal of corporate charters. Those who complain of this provision, however, need not be dealt with simply upon technical legal grounds, as the subject has a very much broader bearing, and we believe that there is no one who would wish to visit any hardship or injustice to the banks simply because Congress was within its legal rights in so doing. The general considerations which make it entirely warantable for Congress to impose certain burdens upon banking institutions as conditions precedent to the grant of national charters to such institutions are quite evident. They appear in all of the various more or less stringent and onerous conditions laid down in the national-bank act for the guidance of the conduct of banking associations. They are also seen in the restrictions imposed by practically all foreign Governments upon the conduct of the banking institutions under their jurisdiction.

The Government, in granting to such banks the power and privilege to operate under the protection and with the prestige of charters emanating from itself, naturally is authorized to make these privileges contingent upon the acceptance of such conditions as it may deem best. Nor is the argument solely to be rested upon these considerations. The proposed bill will ultimately place the banks of the country upon a far more liberal basis than that accorded to them by existing law. This may be demonstrated, among other methods, in the following way. By the terms of the national banking act banks must, in order to become national banks, purchase and deposit with the Treasurer of the United States Government bonds as security for circulation. This requirement is nominally 25 per cent of capitalization for banks up to \$150,000 capital and \$50,000 for all above that level. In reality the requirement is much stronger than this, inasmuch as no notes can be taken out without a deposit of Government bonds behind them. Inasmuch as the supplying of notes is absolutely necessary if the banks are to meet the needs of their customers even in a moderate degree, the proper measure of the burden imposed on them by this requirement is the volume of the bonds that they have purchased. As is shown elsewhere in the present report, this volume of bonds is now something like

\$750,000,000, or very nearly three-quarters of the capital stock of the banks. The proposed bill arranges for releasing the banks from this required investment and substitutes in lieu of it a required investment equal to 10 per cent of their capital (paid up), or not to exceed \$105,000,000. This is one-seventh of the amount now invested in bonds. Inasmuch as the proposed bill allows the conversion of existing 2 per cent bonds into threes at the rate of 5 per cent per annum, while it gives the banks a year within which to enter the proposed reserve banks as stockholders, it is evident that within one year from the latest date set for the subscriptions to the capital stock a bank owning bonds equal to capital would have been able to obtain through conversion and sale of its securities an amount equal to the required investment in capital.

The answer may be made to this statement that the earnings upon the investment in bank stock are unreasonably and unnecessarily small. How much they will be is of course a matter of opinion, since no one can predict the actual profits of the Federal reserve banks. It is, however, worthy of note that even if the earnings were only 5 per cent they would be in excess of the estimated earnings derived from national bank-note issues, which have been notoriously unprofitable for a good while. The banks receive the 2 per cent on their bond investment and the current rate of interest on their notes (provided they can keep them in circulation), but they are obliged to bear the expenses of engraving and printing, redemption, etc., so that it has long been axiomatic that the profits on bank-note circulation were very small—so small that many banks have taken out few notes, some even holding their required minimum of bonds without taking out any currency. From this showing it is evident that the idea of "compulsion," instead of being a novelty is a very old one as well as one that is widely accepted among civilized countries to-day, while the severity and degree of the compulsion as to the use of the bank's current funds entailed by the proposed bill is very much less than that involved in the provisions of the present national bank act. There is in fact no reasonable basis for the complaint with regard to compulsion. National banks after the passage of the proposed bill will be freer, more able to dispose of their funds as they choose, and far less subject to serious interference with their legitimate use of resources than they are to-day.

SECTION 9

Section 9 is a general permission to any State bank to become a national bank and thereby to become eligible upon the same terms

as national banks for membership in a Federal reserve bank as a stockholder. The provisions follow substantially the lines now laid down in the national banking act with reference to the conversion of State banks into national institutions and need no considerable comment, being repeated here for the sake of making plain the conditions under which such conversion may occur subsequent to the passage of this act, that there may be no reasonable doubt in regard to the matter, and that it may be certain under precisely what terms and conditions State banks may make the transfer required.

SECTION 10

After much examination of the subject, it has been deemed best by the committee to permit State banks to become members, i. e., stockholders in Federal reserve banks, without themselves becoming national banks. This concession has been determined upon partly from the standpoint of the banks themselves and partly from that of the new system. The success of the new system would be very largely influenced by its extent and scope. If it becomes practically inclusive of all the banks of the country that are in strong condition, its opportunity for service will be much greater than it could otherwise be. On the other hand, the committee has doubted whether, from the standpoint of the banks themselves, it would be acting fairly were it to debar them from membership in the new concerns.

It has been plain, however, that inasmuch as State banks are organized under different codes of legislation it would be unfair to permit banks to become stockholders in the reserve banks and to enjoy the advantages open to national banks which are stockholders unless such banks were subject to practically as high a standard of banking requirement as the national banks with which they compete. It has been felt that the particulars in which greatest care should be exercised on this score are (a) capital and (b) reserves. The fundamental idea of section 10 is to require compliance with the terms of the bill and of the national banking act as a condition antecedent to the holding stock in a reserve bank by any State bank. This does not altogether place the State banks upon the same basis as the national, inasmuch as they are not thus subjected to the same regulations with respect to investments and general business. It is believed, however, that the principal requirements will thus be met and that the provisions of the section are about as far as the measure can reasonably go with certainty of being held legal and at the same time of proving feasible and available in practice. As a necessary power in connection with

this question of membership section 10 confers upon the Federal reserve board the power to establish by-laws for the general government of its conduct in acting upon applications made by State institutions, while it intrusts to the board the power to approve applications when proper or to suspend banking associations from membership when the provisions of the act are violated, and to secure the cancellation and retirement of their stock, returning the value thereof to the banks so suspended.

SECTION 11

In this section provision has been made for the creation of a general board of control acting on behalf of the National Government for the purpose of overseeing the reserve banks and of adjusting the banking transactions of one portion of the country, as well as the Government deposits therein, to those of other portions. The number of members of this board has been fixed at seven, after careful consideration of other possible memberships, and it has been determined that the board as thus made up should consist of two distinct elements, the one including three regular officers of the National Government, the other four specially appointed officers whose duty it should be to devote their whole time to the management of the affairs of the reserve banks and the performance of the duties assigned them under the present bill. The three officers chosen from the existing staff of the Federal Government are to be the Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency. It is evident that the Treasury Department not only is, but will continue to be, a fundamentally important factor in the financial organization of the country, while the Comptroller of the Currency, in charge as he is of the national banking system, will be a necessary adjunct in the management of the reserve bank system proposed in this bill. The causes for the selection of the two officers thus named are therefore self-evident. The Secretary of Agriculture had been added because of the belief that conditions in the producing regions of the country would deserve special consideration at the hands of the Federal reserve board, the Secretary of Agriculture being the natural representative of the interests of these sections, while it is further thought that the presence of a member on this board whose direct concerns are not primarily those of technical business or banking will be beneficial and will give the deliberations of the board a broader character than they would otherwise possess.

The four members chosen by the President for special service on the Federal reserve board will necessarily be intrusted with the heavier

and routine duties pertaining to this board the regular officers of the Government being naturally engaged in large degree in the discharge of their ordinary functions. It is therefore important to provide for the proper choice of the four officers thus called for. The committee has thought it wise that they should be assigned a tolerably long tenure, and has accordingly fixed that tenure at eight years providing, however, that the first appointees shall be so distributed with respect to tenure of office as to bring about a rotation, so that all members of the board shall not change at any one time. In the second place, it has been deemed wise to provide that not more than two of these four members shall belong to the same political party. It can not be too emphatically stated that the committee regards the Federal reserve board as a distinctly nonpartisan organization whose functions are to be wholly divorced from politics. In order, however, to guard absolutely against any suspicion of political bias or one-sidedness, it has been deemed expedient to provide in the law against a preponderance of members of one party.

The provision that the President in making his selections shall so far as possible select them in order to represent the different geographical regions of the country has been inserted in very general language in order that, while it might not be minutely mandatory, it should be the expressed wish of the Congress that no undue preponderance should be allowed to any one portion of the Nation at the expense of other portions. The provision, however, does not bind the President to any slavish recognition of given geographical sections.

Finally, it has been thought wise to insert a provision that at least one of the four persons so chosen by the President shall be an experienced banker. This, of course, does not mean that other members of the board would be inexperienced in or ignorant of banking. On the contrary, the assumption is that they would not be chosen unless at least tolerably informed in the banking field, and that in all probability they would be not only experienced in banking but men of broad business knowledge and culture. This, however, is a matter that must necessarily be left to the appointive power, which not only should but must, in order to give good results, be vested with discretionary authority sufficient to enable it to make careful choice from among all of the best material available for such a board. It might easily be that a man of high business caliber, thoroughly desirable as a member of the board, would not have had a technical banking experience, notwithstanding that he might be well equipped for the work

The Comptrollers of the Currency in times past have not always been bankers in the technical sense, and some of the most efficient among them have had least technical experience in banking at the time when they assumed office. It is therefore believed safe to vest this whole matter in the hands of the President with large authority, believing that he will be able to use the same care and discrimination that he employs in choosing the Supreme Court of the United States. For obvious reasons it is considered wise that every member of the Federal reserve board designated by the President shall surrender any banking connections he may have had at the time of his nomination, and for equally obvious reasons it is deemed best that the board shall annually report to the House of Representatives, thereby establishing a direct relationship between the board and the Congress. The President is authorized to designate one of the four appointees as manager of the Federal reserve board and one as vice manager, this being deemed wiser than to throw upon so small a board the duty of selecting executive officers from among its own membership. In designating the Secretary of the Treasury as ex officio chairman of the Federal reserve board the bill aims to preserve the general concept of official responsibility and duty which is fundamental to the conception of this board. In ordinary times the Secretary of the Treasury's relation to the board would be largely formal. In times of stress or sudden danger he might become an active and effective working member of the board.

The final paragraph of section 11 is intended to make the Comptroller of the Currency in all respects answerable to the Federal reserve board, thereby giving this board the practical connection it needs with the national banks of the country which are under the direct supervision of the Comptroller of the Currency. This is believed to be desirable, inasmuch as the Comptroller of the Currency, although a member of the Federal reserve board by virtue of the earlier provisions of this section, might otherwise not be held to be answerable to the board in his official capacity as the chief of the national banking system. The paragraph referred to now makes him responsible to the "Secretary of the Treasury acting as the chairman of the Federal reserve board," which implies that the board would have power to instruct the Comptroller upon all necessary matters, preferably through the chairman, whenever action affecting the national banks in those respects in which they are subject to the oversight of the Comptroller was called for. The proviso at the end of the paragraph in question, however, makes it evident that there is nothing in this grant of

authority or in this imposition of responsibility to reduce the functions of the comptroller as at present understood or to render him less amenable than he now is to the Secretary of the Treasury, who is his chief under existing circumstances

SECTION 12

In this section are set forth the basic functions bestowed upon the Federal reserve board. These are not all the powers given to the board, it having been necessary to distribute various other minor grants of authority throughout the bill in the connection to which such grants of authority specifically relate. The provisions of section 12, however, cover sufficiently the fundamental authorities bestowed upon the reserve board. These may now be taken up in order.

(a) In paragraph (a) is given the authority to examine the affairs of each Federal reserve bank, to require statements and reports, and to publish a weekly showing of condition. This is substantially the same kind of authority which is to-day exercised by the Comptroller of the Currency with respect to national banks, except that it is more constant, close, and intimate as the different nature of the case requires. The powers thus bestowed are identical with those granted to the supervising boards in control of the central banks of Europe.

(b) In paragraph (b) is given to the board the authority (1) to permit or (2) to require one Federal reserve bank to rediscount the discounted prime paper of other reserve banks. Much has been said of this grant of authority and it therefore deserves careful analysis. In the first place, it is evident that this power is not different in nature from that which is exerted by the head office of a central bank possessing several branches. Such an office can transfer funds from one to another, and withdraw the service of one for the service of the others. It can, moreover, employ the resources of one portion of the country for the advantage of other portions or for the purpose of safeguarding them at critical times if its managers deem such actions to be wisest. Those, therefore, who favor the idea of a central bank with a single head office, favor it because it grants just this power to dispose of the resources of the one section for the benefit of another, and must in consequence find themselves logically driven to a recognition of the view that such authority to transfer funds and to mass them at points where weakness has been indicated is properly to be exerted in the interest of the public. In the proposed bill, the exercise of such a power is subjected to restrictions which would manifestly and unquestionably make its use sporadic and exceptional,

in so far as it resulted from the exercise of a power to compel the rediscounting of paper by one Federal reserve bank for another. Section 12, in specific terms, explains that the power is to be exerted only "in time of emergency" and by a unanimous vote of the reserve board. It, moreover, imposes a penalty charge of from 1 to 3 per cent upon the grant of such an accommodation. The power is clearly much less than that which has been advocated by friends of the central bank idea, inasmuch as it suggests an exceptional or occasional resort to an expedient which would be the staple of everyday business under a central banking plan, such as that proposed by the National Monetary Commission. The other side of the function—that of permitting Federal reserve banks to rediscount for one another—has also been objected to on the ground that such banks should be allowed to deal with one another freely if they choose. The committee does not concede this view, but believes that the banks should not thus be allowed to deal with one another except under oversight, in view of their distinct character as reserve holders.

(c) Paragraph (c) grants the Federal reserve board the power to suspend the reserve requirements of the act for designated periods if in its judgment such action may be deemed wise. There is nothing unusual or revolutionary in this requirement, it being in practice somewhat akin to the power granted the Comptroller of the Currency in section 5191, Revised Statutes, where he is practically able to permit national banks to go below their reserve for 30 days. In practice this power is constantly exercised by him subject to his judgment. The power is suggested by the process of "suspending the bank act" in England, and is a desirable administrative function in every case where a fixed reserve requirement is employed.

(d) The power to supervise and regulate the retirement of Federal reserve notes granted in this paragraph is of course a necessary concomitant to Government control of note issues a matter to be discussed in detail in connection with the provisions for note issue.

(e) In paragraphs (e), (f), (g), (h), and (i) are conveyed powers which are largely self-explanatory and about which there can be little or no question, granting the general idea of effective Government oversight through a Federal reserve board or some similar organization.

In view of the fact that the Federal reserve board is vested with functions other than those formally enumerated in section 12, it may be worth while to list the chief powers conferred upon the board by the act as follows:

POWERS OF THE FEDERAL RESERVE BOARD

To readjust districts created by the organization committee and create new ones, acting upon a joint application made by 10 of the national banks within an existing district

To regulate the establishment of branches of Federal reserve banks within Federal reserve district in which bank is located

To designate three (class C) of the nine members of the board of directors of each Federal reserve bank, one of these to be chairman of the board with the title of "Federal reserve agent"

The Federal reserve agent to maintain a local office of the Federal reserve board on the premises of the Federal reserve bank. He shall make regular reports to Federal reserve board and be its official representative

To remove any director of class B (business men) if it should appear that he does not fairly represent the commercial, agricultural, or industrial interests of his district

To remove chairman of Federal reserve bank without notice

To establish by-laws governing applications from State banks and trust companies

"Of the four persons * * * appointed (by the President), one shall be designated manager and one vice manager of the Federal reserve board." The manager, subject to supervision of the Secretary of the Treasury and board, shall be the active managing officer of the Federal reserve board

To levy a semiannual assessment upon the Federal reserve banks, for estimated expenses for succeeding six months, together with deficit carried forward

To examine at its discretion the accounts, books, and affairs of each Federal reserve bank and to require such statements and reports as it may deem necessary

To require, or on application to permit, a Federal reserve bank to rediscount the paper of any other Federal reserve bank

To suspend, for a period not exceeding 30 days (and to renew such suspension for periods not to exceed 15 days), any and every reserve requirement specified in this act

To supervise and regulate the issue and retirement of Treasury notes to Federal reserve banks

To add to the number of cities classified as reserve and central reserve cities under existing law in which national banking associations are subject to the reserve requirements set forth in section 21 of this act, or to reclassify existing reserve or central reserve cities and to designate the banks therein situated as country banks, at its discretion

To require the removal of officials of Federal reserve banks for incompetency, dereliction of duty, fraud, or deceit

To require the writing off of doubtful or worthless assets upon the books and balance sheets of Federal reserve banks

To suspend the further operations of any Federal reserve bank and appoint a receiver therefor

To perform the duties, functions, or services specified or implied in this act

To determine or define (subject to stipulations) the character of paper eligible for discount for member banks

To prescribe regulations for purchase and sale by Federal reserve banks of bankers' bills, etc

To review and determine the minimum rate of discount established by Federal reserve banks

To authorize establishment of branches of Federal reserve banks in foreign countries

To authorize the issue of Federal reserve Treasury notes

To receive, through the local Federal reserve agent, applications from Federal reserve banks for notes, such applications to be accompanied by rediscounted notes for deposit as collateral security

To require Federal reserve bank to maintain deposit in money of 5 per cent of notes issued

To grant in whole or in part or to reject entirely the application from Federal reserve bank for notes

To establish rate of interest on notes issued

To prescribe regulations for substitution of collateral

To make and promulgate regulations governing the transfer of funds at par among Federal reserve banks

To act, if desired, as clearing house for Federal reserve banks

To require, in its discretion, Federal reserve banks to act as clearing houses for shareholding banks

To prescribe regulations for the recall and redemption of all national-bank notes outstanding after 20 years

To require extra examinations of national banks when deemed necessary

To determine and report annually to Congress fixed salaries of all bank examiners

To assess upon banks in proportion to assets or resources the expenses of examinations To fix a date for such assessment

To arrange for special or periodical examinations of member banks for account of Federal reserve banks

To receive from Federal reserve banks information concerning the condition of any national bank in its district

To order examinations of national banks in reserve cities as often as necessary, not less than four times a year

To add to the list of cities in which national banks shall not be permitted to loan on real estate as described

To receive applications from national banks having \$1,000,000 or more capital for the establishment of branches in foreign countries, to reject or accept such applications, and to prescribe conditions under which such branches may be opened

To require examinations of foreign branches as it may deem best

To regulate savings departments of national banks and to prescribe their investments

SECTION 13

Section 13 provides for the creation of a Federal advisory council which is to consist of as many members as there are Federal reserve districts, each such district electing through the board of directors of its Federal reserve bank a representative of that bank The functions of this board are wholly advisory and it would amount merely to a means of expressing banking opinion, informing the reserve board of conditions of credit in the several districts, and serving as a source of information upon which the board may draw in case of necessity The desirability of such a body as a source of information and counsel is obvious, and it is believed that it gives to the banking interests of the several districts ample power to make their views known, and, so far as they deserve acceptance, to secure such acceptance

SECTION 14

In section 14 is set forth the fundamental business purpose of the bill in providing for rediscount operations. The Federal reserve banks are at the outset authorized to receive current deposits from their stockholders or from the Government or from other Federal reserve banks in so far as the latter may need to keep funds with them for exchange purposes.

The fundamental requirement throughout all of the discount section of the proposed bill is that antecedent to the performance of a service by a Federal reserve bank for a member bank which applies therefor the member bank shall indorse or guarantee the obligations which it offers for rediscount. Subject to this requirement, the proposed bill first of all provides that notes and bills having a maturity of not over 90 days and drawn for agricultural, industrial, or commercial purposes or the proceeds of which have been used for such purposes shall be admitted to rediscount. The meaning of this provision is briefly that any paper drawn for a legitimate business purpose of any kind may be rediscounted when within 90 days of maturity. It does not mean that the paper thus rediscounted shall have been originally made for 90 days, but that it shall have at the time of being rediscounted 90 days more to run. Thus a paper drawn for 120 days originally could be rediscounted when it was 30 days old. In view of the great difficulty of defining "commercial paper," the actual definition of the same has been left to the Federal reserve board in order that it may adjust the definition to the practices prevailing in different parts of the country in regard to the transaction of business and the making of paper. For obvious reasons it is forbidden that any such paper shall be admitted to rediscount if made for the purpose of carrying stocks or bonds.

It was felt that in some parts of the country the permission to rediscount paper having a maturity of 90 days might not fulfill all of the requirements imposed by the business practice of those regions, and therefore it is provided in the third paragraph of section 14 that, whenever the reserve of any Federal reserve bank is reasonably above its required minimum (such excess margin to be determined by the Federal reserve board), the reserve bank may rediscount commercial paper having a maturity of not more than 120 days, provided that not more than one-half of it shall have a maturity exceeding 90 days. This is intended to fulfill the requirements of portions of the country with an extremely long term of credit, but it is clear that no reserve bank should be allowed to put its funds into a form in which they

will be "tied up" to such an extent unless such a bank has a reserve perfectly adequate to take care of any necessities that are likely to present themselves in the meantime

The fourth paragraph of section 14 grants permission to reserve banks to rediscount acceptances of member banks which are based on the exportation or importation of goods, run not more than six months, and bear the signature of one member bank in addition to that of the acceptor, the total of such rediscounts not to exceed one-half the capital of the bank for which the rediscounts are made. In the sixth paragraph, national banks are authorized to accept drafts or bills of exchange drawn upon it to an amount not exceeding one-half its capital. The acceptance business, which it is thus proposed to authorize, is a new form of business heretofore forbidden to national banks, by reason of the provisions and interpretations of the national-banking act, which have forbidden them to lend their credit or to incur contingent liabilities thereby. The acceptance form of loan is, however, very common in Europe, and has been found exceedingly serviceable. It is the opinion of expert bankers that it could be applied in the United States to excellent advantage. The following extract from a discussion of acceptances by Lawrence Merton Jacobs explains the method and purpose of the acceptance business.

"The fundamental difference between European and American banking has its origin in the dissimilarity between the evidences of indebtedness which lie behind the item of loans and discounts. It is most strikingly evidenced in the fact that time bills of exchange form a considerable proportion of the resources of the great banks of London, Paris, and Berlin, whereas the assets of leading New York banks are largely based on stocks and bonds.

"Of the bills of exchange in which are employed, either through loans or discounts, the funds of European banks, an essential part consists of what are known as bankers' bills—that is, bills drawn on bankers and accepted by them on behalf of customers in accordance with arrangements previously made. They are bills in exchange for which, by sale to a broker or by discounting at a bank, bankers' customers or those to whom they are indebted may secure immediate credit. In some instances it is arranged that the customers themselves shall draw the bills and in others that the bills shall be drawn by third parties for their account. In granting the accommodation the obligation that the bankers take upon themselves is that they will accept the bills upon presentation. This acceptance consists in the bankers writing across the face of the drafts the word 'Accepted,'

adding their signature and the date. It is in the nature of a certification that the bills will be paid at maturity—that is, a specified number of days or months from the date appearing in the acceptance, or three days later if grace is allowed, as in England. When a banker grants accommodation to a customer by means of an acceptance he may secure himself in various ways. Ordinarily a banker accepts a customer's draft merely upon his general responsibility, the banker's risk being much the same as if he had discounted the customer's note running a certain length of time. Where the customer is an importer the banker ordinarily accepts the drafts upon the delivery to him of the documents covering the shipment, which documents he then turns over to his customer against a trust receipt. When a credit of this kind is opened the usual practice is for the banker to require the signature of a form containing an agreement to hold him harmless for accepting the bills, to place him in funds sufficient to pay off the bills three days prior to their maturity, and to pay him a commission on the transaction, this commission varying according to the length of time the bills are to run and the financial standing of the customer. The cost of the accommodation to the customer is this commission plus the prevailing rate of discount for bankers' bills.

"In the United States the national-bank act does not permit banks to accept time bills drawn on them. Although the act does not specifically prohibit such acceptances, the courts have decided that national banks have no power to make them. This restriction has had a very considerable influence upon the development of banking in this country. For some time after the passage of the national-bank act, merchants and manufacturers provided themselves with funds by discounting their promissory notes with their local banker. Gradually, however, many concerns, finding that their needs were outstripping the banking accommodation which they could secure in their immediate vicinity, came to place their notes in the hands of brokers who in turn disposed of them to such bankers as possessed greater surpluses than they could satisfactorily invest at home. It is this method of borrowing which is now largely employed. In other words, the prohibition of bank acceptances has led to the creation of a vast amount of promissory notes instead of time bills of exchange. The difference between these two classes of instruments accounts to a great extent for the difference between European and American banking. In the case of time bills of exchange drawn on and accepted by prime banks and bankers there is practical uniformity of security. In the case of our promissory notes or commercial paper there is no

such uniformity, the strength of the paper depending on the standing of miscellaneous mercantile and industrial concerns

"It is this uniformity of security on the one hand which makes possible a public discount market, it is the lack of it in single-name paper which makes such a market impossible. As a result, we have great discount markets in London, Paris, and Berlin, and none in New York. In European centers the discount rate is the rate upon which the eyes of the financial community are fixed. In New York it is the rate for day-to-day loans on the stock exchange. The advantage in character of the one rate over the other clearly indicates an important advantage of European banking systems over our own. In the first place, the European discount rate bears a very direct relation to trade conditions. Its fluctuations depend primarily on the demand for and supply of bills which owe their origin to trade transactions, as balanced against the demand for and supply of money. If trade is active, the supply of bills becomes large, rapidly absorbing the loanable funds of the banks. As these surplus funds become less and less banks are unwilling to discount except at advanced rates. If trade is slack, less accommodation from bankers in the way of acceptances is required, bills become fewer in number, the competition for them in the discount market more keen, and the rate of discount declines. Low rates are an incentive to business and advancing rates act as a natural check. The New York call-loan rate, on the other hand, bears only an indirect relation to trade conditions. Its day-to-day fluctuations register mainly the speculative and investment demand for stocks. Low rates, instead of being an incentive to the revival of trade, are rather made the basis for speculative operations in securities.

"The striking difference, however, between European discount rates and the New York call-loan rates is that the former are comparatively stable and the latter subject to most violent oscillations. Foreign discount rates as bank reserves become depleted advance by fractions of 1 per cent. In New York the money rate advances on occasion 10 per cent at a time, mounting by leaps and bounds from 20 per cent to 100 per cent in times of stress."

AMOUNT OF REDISCOUNTS

There has been extensive conjecture as to the probable amount of business which could be done by the Federal reserve banks under the foregoing provisions and regarding the amount of paper likely to be presented by the banks for rediscount. Such conjecture is more or less profitless, for two reasons

1 The rediscount business done in the United States heretofore has been small, partly because of the limitations of the national-bank act and partly because of the prejudice against borrowing by banks, which has more or less artificially sprung up

2 The purpose of the new act is to develop a commercial paper market, and if successful in this endeavor the legislation will entirely transform the conditions under which paper is bought and sold, loans contracted between banks, and funds transferred from one part of the country to another

While it is thus true that the facts as to existing conditions do not throw much light upon what is to be expected and that conjectures based upon them are futile, it is worth while to call attention to the following table, taken from the last annual report of the Comptroller of the Currency, which gives a compact survey of the classes of paper which might theoretically be available for rediscount under the provisions of the act as already explained

1	2	3	4	5	6	7	8
Date	Number of banks	On demand, paper with one or more individual or firm names	On demand, secured by stocks, bonds, and other personal securities	On time, paper with two or more individual or firm names	On time, single-name paper (one person or firm) without other security	On time, secured by stocks, bonds, and other personal securities, or on mortgages or other real estate security	Total
		<i>Millions</i>	<i>Millions</i>	<i>Millions</i>	<i>Millions</i>	<i>Millions</i>	<i>Millions</i>
Sept 15, 1902	4,601	\$237 3	\$706 9	\$1,176 4	\$517 1	\$642 4	\$3,280 1
Sept 9, 1903	5,042	283 1	717 3	1,267 5	558 1	655 4	3,481 4
Sept 6, 1904	5,412	279 8	818 9	1,316 7	611 0	699 7	3,726 2
Aug 25, 1905	5,757	320 1	854 1	1,382 2	689 1	753 0	3,998 5
Sept 4, 1906	6,137	374 7	828 0	1,502 0	776 1	818 1	4,299 0
Aug 22, 1907	6,544	428 2	832 9	1,648 7	899 5	869 2	4,678 5
Sept 23, 1908	6,853	395 9	922 7	1,582 4	852 1	997 5	4,750 6
Sept 1, 1909	6,977	441 5	957 3	1,698 4	971 5	1,060 1	5,128 8
Sept 1, 1910	7,173	524 3	939 1	1,842 5	1,068 3	1,093 0	5,467 2
June 7, 1911	7,277	529 7	953 8	1,885 1	1,124 7	1,117 5	5,610 8
June 14, 1912	7,372	571 3	985 4	1,973 4	1,198 5	1,225 3	5,953 9

The columns numbered 3, 5, and 6 are those which represent paper potentially available under the act

The fifth paragraph of section 14 forbids the rediscounting for any one bank of an aggregate of notes and bills bearing the signature or indorsement of any one person or concern, this being a repetition of the prohibition of similar kind which is contained in the national banking act. A new feature is, however, found in the last sentence of the paragraph in question, which reads as follows. "But this

restriction shall not apply to the discount of bills of exchange drawn in good faith against actually existing values" This exception or exemption has long been asked for in the interest of legitimate business transactions Obviously when a bill of exchange is secured by bills of lading and other documents accompanying it, it is primarily dependent for liquidation upon this unquestionably marketable wealth There is therefore no reason for limiting the amount of the discount to be granted by any reference to the resources of the person applying for the accommodation or by the capital and surplus of the bank granting the discount, that being merely a question of banking judgment, while the bill itself is salable and will presumably be protected at the point where it is presented

Summing up the terms of section 14, therefore, it may be said that the section simply applies to the Federal reserve banks the same general grants of authority and limitations thereon carried in the national-bank act with respect to the national banks, except that it more carefully limits the length of the paper to be rediscounted and the purpose for which it is drawn, while it opens the acceptance business to national banks and permits the rediscount of acceptance paper The latter class of paper is limited to export and import operations in order to prevent any possibility of undue use of the provision at first by banks not thoroughly conversant with the working of the idea owing to lack of experience with this type of credit

SECTION 15

It will have been observed that the transactions authorized in section 14 were entirely of a nature originating with member banks and involving a rediscount operation It is clearly necessary to extend the permitted transactions of the Federal reserve banks beyond this very narrow scope for two reasons

- 1 The desirability of enabling Federal reserve banks to make their rate of discount effective in the general market at those times and under those conditions when rediscounts were slack and when therefore there might have been accumulation of funds in the reserve banks without any motive on the part of member banks to apply for rediscounts or perhaps with a strong motive on their part not to do so

- 2 The desirability of opening an outlet through which the funds of Federal reserve banks might be profitably used at times when it was sought to facilitate transactions in foreign exchange or to regulate gold movements

In order to attain these ends it is deemed wise to allow a reserve

bank, first of all, to buy and sell from anyone whom it chooses the classes of bills which it is authorized to rediscount. The reserve bank evidently would not do this unless it should be in a position which, as already stated, furnished a strong motive for so doing. Outright purchases in the open market would of course require the payment of the face of the paper less discount, whereas rediscount operations would require simply the holding of a reserve of $33\frac{1}{3}$ per cent behind the notes issued or deposit accounts created in the course of the rediscount operation. Apart from this fundamental permission, it was deemed wise to allow the banks to buy coin and bullion and borrow or loan thereon and to deal in Government bonds. The power granted in subsection (d) to fix a rate of discount is an obvious incident to the existence of the reserve banks, but the power has been vested in the Federal reserve board to review this rate of discount when fixed by the local reserve bank at its discretion. This is intended to provide against the possibility that the local bank might be establishing a dangerously low rate of interest, which the reserve board, familiar as it would be with credit conditions throughout the country, would deem best to raise.

The final power to open and maintain banking accounts in foreign countries for the purpose of dealing in exchange and of buying foreign bills is necessary in order to enable a reserve bank to exercise its full power in controlling gold movements and in facilitating payments and collections abroad.

SECTION 16

Section 16 provides for the transfer of all moneys now held in the general fund of the Treasury to the reserve banks, disbursements to be thereafter made by check upon such banks. The general philosophy of this proposed change and the conditions which imperatively demand it have been sufficiently sketched at an earlier point in this report, and it is only necessary here to examine the actual working of the provision. Twelve months are allowed to effect the transfer, this being deemed a sufficient time in view of the comparatively low state of the Government's deposits in banks today. The apportionment of the funds between banks is required to be made as equitably as possible between the different sections of the country, this proviso being practically a repetition of the language found in the national-bank act today. The Federal reserve board and the Secretary of the Treasury are left with full power to fix a rate of interest from month to month on the deposits, this to be not less than one-half of 1 per cent.

How large a transfer of funds would be effected under the terms of this provision, and how such a transfer would affect the Treasury itself, will depend upon the condition of the Treasury at the time of the passage of the act, but an approximate idea may be formed from the daily Treasury statement, a copy of which is hereto appended

SECTION 17

The subject of note issue has occasioned the committee no little concern, but after due and full consideration it has determined that the proper mode of note issue to be provided for in the proposed act is that of an issue of government Treasury notes, obligations of the United States and receivable for all taxes, customs, and other public dues. Recognizing that the country is now definitely committed to the immediate redemption of all existing paper currency in lawful money, upon demand, the proposed measure requires the redemption of such notes both at the Treasury and at each of the Federal reserve banks at par when requested.

Recognizing, moreover, that the regulation of the volume of currency in circulation—as distinct from the underlying money of ultimate redemption—is a delicate function requiring to be adjusted in accordance with the commercial, agricultural, and industrial needs of the country, the power of getting out the notes by making application for them is by the bill given to Federal reserve banks, they being required to furnish the local Federal reserve agent with collateral security consisting of rediscounted notes and bills to a sum equal to the amount of the notes issued to the Federal reserve bank in question. These operations, connected with the issue and retirement of reserve notes, are to be carried on through the local Federal reserve agent, who is daily to notify the reserve board of issues and withdrawals. Such reserve notes are required to be protected by a specially segregated reserve fund of $33\frac{1}{3}$ per cent in lawful money.

The mode of protecting the notes is an essential and fundamental element in this section of the bill. A first lien on all assets and a Government guaranty of the goodness of the notes obtained by making them liabilities of the United States render the security behind the issue absolute, both as to immediate and as to ultimate conditions. It may thus be fairly said that the protection of the notes as distinct from their redemption is as follows: (1) Government promise to receive them and to be ultimately responsible for them, (2) first lien on all the assets of the bank issuing them, (3) direct lien on 100 per cent of prime paper specially selected and segregated for their protection,

(4) claim on $33\frac{1}{3}$ per cent of money drawn from the general funds of the bank and re-created as fast as notes are redeemed, that there may always be a special fund for the immediate protection of the issues

While the notes are, under the new section, allowed to carry on their faces a letter and serial number distinguishing them from others, they are not suffered to bear the name of the bank through which they are issued, and the fundamental feature of this peculiar "Government" character is that they are required to be redeemed at the counter of every Federal reserve bank, no matter whether such bank has issued any notes, and no matter how many notes it may have issued. This signifies that every Federal reserve bank is a redemption agency for the whole of the issue, and the question at once arises, Out of what will such reserve bank redeem the notes should a great quantity be thrown in upon it? The section provides that such a bank may, if it chooses, (1) pay the notes out of the $33\frac{1}{3}$ per cent fund of lawful money or gold held by it for the redemption of its own notes, re-creating such fund at once from any other funds held by it for its other liabilities, (2) charge the notes off against Government deposits held by it (and against which, of course, there is a reserve of $33\frac{1}{3}$ per cent of lawful money), which would mean that such bank would at once send the redeemed notes to the Treasury and get back an equal amount of fresh Government deposits, or (3) present the notes presented to it for redemption, although issued by some other Federal reserve bank, to the Treasury for redemption. In either of these latter cases, of course, the result would be to throw on the Treasury the work of getting back the amount of the redeemed notes by sending them to the bank, through which they were originally issued. In addition to these provisions, of course, it is required in other sections of the bill that every bank in the system shall receive the notes on deposit at par, and that they shall be payable to the Government for taxes, dues, and other public requirements.

All this shows how the notes are protected and how they can easily be redeemed by a man who is desirous of getting lawful money for his notes without any cost to himself. There is little doubt that his interests under the provisions of the measure are quite thoroughly safeguarded. But there remains the general question whether the public requirement of elasticity has been met and provided for. Elasticity must be considered from two standpoints—that of expansion and that of contraction. As to expansion, the regulatory mechanism is the Federal reserve board, which is given the power to veto applications for notes. The board, however, can not issue notes unless they are

applied for and accompanied by a tender of proper commercial paper. This at least seems to assure that they will not be hastily or rashly overissued. The contraction feature is more difficult. In attempting to guard against the danger that the notes might remain in circulation after the need for them had passed, the bill makes the following provisions: (1) The notes can not be used in bank reserves, (2) the notes are not to be legal tender, (3) the notes can not be paid out by any Federal reserve bank (when not at first issued by it) under penalty of a tax of 10 per cent on their face value, (4) every Federal reserve bank is directed, upon receiving the note of another reserve bank, to (a) either send it direct to the bank that issued it, (b) to send it to the Treasury, charging it off against deposits, or (c) to present it to the Treasury for redemption in lawful money. On the other hand, the Treasury is directed when it gets such notes in ordinary receipts to have them redeemed out of a 5 per cent fund kept with the department for that purpose, and then to send them home for ultimate redemption. The belief is freely expressed that these provisions will maintain the notes at par everywhere and will also prevent them from expanding or remaining out after the need for them has gone by.

There is a final paragraph in section 17 relating to the collection at par and without charge for exchange of certain classes of checks. The provision is that every Federal reserve bank shall receive on deposit at par the following classes of items:

- 1 Checks and drafts drawn upon any of its depositors
- 2 Checks and drafts drawn by any of its depositors upon any other depositor
- 3 Checks and drafts drawn by any depositor in any other Federal reserve bank upon funds to its credit in such reserve bank

The object of these provisions is twofold:

- 1 To establish par transfers of funds among the banks in each Federal reserve district
- 2 To establish par transfers of funds between Federal reserve districts

Precisely how much difficulty and cost will be incurred by the Federal reserve banks in carrying out the provisions of this section can not be precisely calculated. It can, however, be positively stated that such expenditures will be very much less than those incurred by banks at the present day in carrying through their exchanges. The proposed provision will eliminate the numerous and well-founded complaints of unjust charges for exchange, and, while it will prevent certain banks from profiting as they now do by exchange transactions, it will cor-

respondingly benefit the community. The committee is well aware that the operation of this section will undoubtedly relieve some members of the community of greater burdens than others. It does not, however, consider the fact that some persons have been suffering an unnecessary burden under existing circumstances, a good reason for refusing or failing to provide for an important public function.

That this function of exchange may be effectively carried out, and that other duties connected with relations between the several banks of the system may be wisely, promptly, and effectively carried through, the proposed bill confers upon the Federal reserve board the power to require each Federal reserve bank to perform the functions of a clearing house, and at its discretion to require some one of them to act as a clearing house for all the others or at its own discretion to act as a clearing house in this way itself.

SECTIONS 18 AND 19

Sections 18 and 19 may best be treated together, as they jointly provide for the disposal of existing national-bank notes and for the refunding of the bonds now held by the banks behind these notes. The general views entertained by the committee with respect to bank-note issue in general and the treatment of existing national-bank notes in particular have been sufficiently set forth at an earlier point in this report. It remains here to outline the exact steps that have been recommended to attain the desired end, and to indicate the probable cost and incidental problems connected with each step in the process.

1 Provision has been made for paying at the end of 20 years the existing outstanding 2 per cent bonds. This is a manifest matter of justice.

2 Meantime banks have been permitted at their discretion to present one-twentieth of their bond holdings each year for conversion into 3 per cent bonds, and in the event they do not so present them the Secretary of the Treasury is authorized to reassign the quotas of bonds not taken up to other banks which are authorized to in that case secure a corresponding amount of additional conversions.

3) During the 20-year period any bank may increase or decrease its circulation at pleasure, subject to the maximum limitation prescribed by law.

4 However, from the date of the passage of the act no national bank is to be required to hold any United States bonds as security for circulation if it chooses to retire such circulation—in other words, the compulsory bond-purchase requirement of existing law is repealed.

It will be seen that the only interference with the existing demand for bonds provided under these sections is the withdrawal of the compulsory bond purchase now required. Precisely how great a limitation of the bond demand this would furnish can not be precisely stated. For the last year for which full report was made by the Comptroller of the Currency (1912) the net amount of bonds purchased by national banks to protect circulation was about \$16,000,000. This, however, was far in excess of the amount of bonds necessarily to be purchased under the compulsory-purchase requirement, inasmuch as many banks bought more bonds than they were obliged to secure under the terms of the national-bank act. There is no reason why this demand for bonds should not continue, as in fact it undoubtedly will. The capitalization of banks organized in the year in question was \$16,080,000, while the amount of bonds purchased was about the same. If the amount of bonds required to be purchased be assumed to have been 25 per cent of the face of the capital of the newly organized banks it would have been \$4,000,000, and this may be taken as considerably above the amount of compulsory demand for bonds for which there will no longer be legal basis should the present bill be enacted into law. As against this the Government stands ready to redeem in the form of 3 per cent bonds, roughly speaking, \$37,000,000 per annum, and it is only reasonable to suppose that under the most unfavorable conditions the quantity of 2 per cent bonds which will be converted into threes in this way will be far in excess of the amount of the compulsory demand for twos which is now cut off.

The future of the 3 per cent bonds, should the conversions go on at the rate of 5 per cent per annum, may be open to some question. The committee has, however, consulted able expert opinion upon this subject and has found a practical unanimity of view to the effect that at least \$50,000,000 per annum in 3 per cent bonds can and will be absorbed in the United States at par. Should such prove not to be the case, the banks have only to retain their present bonds and continue the issue of circulation thereon, but it is confidently believed that no such situation will occur. The committee looks forward with assurance to the conversion of a very considerable percentage, if not all, of the permitted 5 per cent in each successive year during the earlier part at least of the 20-year period. As the 20-year period draws toward a close it is quite likely that some bondholders will prefer to hold their bonds for redemption, but in the meantime there will have been a sufficient retirement of national-bank notes to impart to the new currency to be put out through the Federal reserve banks the desired

quality of elasticity In order to improve the market for the 3 per cent bonds, section 19 provides that they are to be free from all taxation both as to income and principal It will be remembered that the status of the bonds is further helped in some measure by the provision made in the earning section (sec 7) for devoting the Government share of reserve bank earnings to the redemption of bonds As a corollary of the bond-refunding plan and of the note section the committee has deemed it wise to insert in section 19 a prohibition upon the further use of the extra-legal substitutes for circulating notes which have heretofore done duty in times of panic under the form of clearing-house certificates, cashiers' checks, and various substitutes for actual money which have been illegally paid out by banks to their creditors in lieu of the payment in the usual forms of currency employed by them during normal times No such expedients would have been permitted save under severe stress, and with a suitable provision for an elastic note issue based upon commercial paper they should not longer be suffered to continue in use

The amount of 2 per cent and other bonds now held behind circulation and affected by the provisions of sections 18 and 19 may be recapitulated as follows

SECTION 20

Section 20 seeks to readjust the reserve requirements now provided by the national banking act in such a way as to make them conform to the dictates of scientific banking, and to adjust them to the provisions of the proposed bill The following main objects have been had in mind

- 1 To abolish entirely the present system of redeposited or "pyramided" reserves

- 2 To establish a moderate required reserve actually to be held in cash in the vaults of the banks

- 3 To prescribe a secondary reserve to take the form of a credit with the Federal reserve banks

Several serious problems at once suggest themselves as the result of any effort to attain these objects In the first place, the present conditions have grown up over a period of 50 years, and it is not desirable, even if it were safe, to disturb them roughly Secondly, it is considered that, existing reserve requirements being based upon the state of affairs in which many independent banks were working without coordination, it is possible to reduce the actual amount of reserves to be held Finally, it is noted that in making the change

Bonds held in trust for National Banks, Sept 2, 1913

Kind of bonds	Rate of interest	Total amount outstanding	Bonds held for national banks			
			Total	To secure circulation	To secure deposits of public moneys	
					Value at par	Value at rate approved by department
GOVERNMENT						
U S loan of 1925 at par	4	\$118,480,000	\$37,660,400	\$34,181,700	\$3,487,700	\$3,487,700
U S loan of 1908-18 at par	3	63,945,400	25,828,900	3,646,700	3,646,700	3,646,700
U S Panama of 1961 at par	3	50,000,000	17,110,200	17,110,200	17,110,200	17,110,200
U S consol of 1930 at par	2	646,250,150	615,921,100	603,773,900	12,147,200	12,147,200
U S Panama of 1936 at par	2	54,631,980	54,242,360	52,062,860	1,279,500	1,279,500
U S Panama of 1938 at par	2	30,000,000	20,444,140	28,897,140	547,000	547,000
Philippine loans at par	4	16,000,000	5,967,000		5,967,000	5,967,000
Porto Rico loans at par	4	5,225,000	1,821,000		1,821,000	1,821,000
District of Columbia at par	3	6,970,650	933,000		933,000	933,000
Territory of Hawaii, 3½ per cent bonds at 90 per cent of par, all other Hawaiian bonds at market value, not exceeding par	(1)	6,515,000	1,978,000		1,978,000	1,930,900
MISCELLANEOUS						
Philippine Railway Co	4	8,551,000	898,000		898,000	588,571
Manila Railroad Co	4	6,735,000	10,000		10,000	6,750
At 90 per cent of market value not exceeding 90 per cent par						
IV State county, city, and other securities ²	(1)		17,951,137		17,951,137	11,747,904
Total			809,774,237	741,997,800	67,776,437	61,213,425

¹ Various² As security for deposits made in connection with crop movement Government bonds are accepted at par, other bonds at 75 per cent of market value, and commercial paper at 65 per cent of face value.

When banks have occasion to withdraw bonds held by the Treasurer to secure deposits of public moneys the following shall be the order of withdrawal: Group IV, Group III, Group II, and Group I.

Bonds of that group may be interchanged by banks if desired but bonds in a lower group may not be substituted for those in a higher group, except that partial substitution of bonds of a higher group may be made to an amount not to exceed 30 per cent of the total security value of bonds held for a particular bank. National-bank depositaries which have not as yet taken out the full amount of circulation authorized by law may withdraw United States 2s and substitute for them bonds in Group II, provided the 2s withdrawn shall be used as security for additional circulation.

suggested careful account must be taken of the total sums in cash as distinct from those in balances required to be held by existing law, and that they should be contrasted with the sums in cash and balances prescribed under the proposed bill. In surveying the situation a beginning may be made by considering with care the reserve requirements of the national bank act. These are as follows:

RESERVE CITIES AND RESERVE REQUIREMENTS

120 SEC 5191 Every national banking association in either of the following cities, Albany, Baltimore, Boston, Cincinnati, Chicago, Cleveland, Detroit, Louisville, Milwaukee, New Orleans, New York, Philadelphia, Pittsburgh, St. Louis, San Francisco, and Washington, shall at all times have on hand, in lawful money of the United States, an amount equal to at least twenty-five per centum of the aggregate amount of [*its notes in circulation and*] its deposits, and every other association shall at all times have on hand, in lawful money of the United States, an amount equal to at least fifteen per centum of the aggregate amount [*of its notes in circulation and*] of its deposits. Whenever the lawful money of any association in any of the cities named shall be below the amount of twenty-five per centum of its [*circulation and*] deposits, and whenever the lawful money of any other association shall be below fifteen per centum of its [*circulation and*] deposits, such association shall not increase its liabilities by making any new loans or discounts otherwise than by discounting or purchasing bills of exchange payable at sight, nor make any dividends of its profits until the required proportion, between the aggregate amount of its [*outstanding notes of circulation and*] deposits and its lawful money of the United States, has been restored. And the Comptroller of the Currency may notify any association whose lawful money reserve shall be below the amount above required to be kept on hand to make good such reserve, and if such association shall fail for thirty days thereafter so to make good its reserve of lawful money, the comptroller may, with the concurrence of the Secretary of the Treasury, appoint a receiver to wind up the business of the association, as provided in section fifty-two hundred and thirty-four.

NOTE—This section is amended by the act of June 20, 1874, section 2, which provides that no reserve need be held against circulation. Said act follows section 5192. Act of March 3, 1903, amending act of March 3, 1887, providing for additional reserve cities, follows section 5192. Provisions relating to redemption of circulating notes, acts June 20, 1874, March 3, 1875, and July 14, 1890, follow Revised Statutes, 5192. Provisions relating to redemption of old notes of banks extending their corporate existence, act July 12, 1882, follows Revised Statutes, 5136. Leavenworth, Kansas, was included as a reserve city in the original act, but was struck out March 1, 1872. Words "lawful money" construed by Attorney General as including all that is legal tender. (Opin. Atty. Gen., 17, 123.)

WHAT MAY BE COUNTED AS A RESERVE

121 SEC 5192 Three-fifths of the reserve of fifteen per centum required by the preceding section to be kept may consist of balances due to an association, available for the redemption of its circulating notes, from associations approved by the Comptroller of the Currency, organized under

the act of June three, eighteen hundred and sixty-four, or under this title, and doing business in the cities of Albany, Baltimore, Boston, Charleston, Chicago, Cincinnati, Cleveland, Detroit, Louisville, Milwaukee, New Orleans, New York, Philadelphia, Pittsburg, Richmond, Saint Louis, San Francisco, and Washington Clearing-house certificates, representing specie or lawful money specially deposited for the purpose, of any clearing-house association, shall also be deemed to be lawful money in the possession of any association belonging to such clearing house, holding and owning such certificate, within the preceding section

NOTE—Leavenworth, Kansas, was included as a reserve city in the original act but was struck out March 1, 1872. Charleston and Richmond not being included in the list of reserve cities enumerated in section 5191, the banks of which are required to hold a reserve of twenty five per centum of their net deposits, the Comptroller of the Currency has never approved any banks in said cities as reserve agents

LAWFUL MONEY RESERVE TO BE DETERMINED BY DEPOSITS ACT JUNE
20, 1874

122 SEC 2 That section thirty-one of "the national-bank act" be so amended that the several associations therein provided for shall not hereafter be required to keep on hand any amount of money whatever, by reason of the amount of their respective circulations, but the moneys required by said section to be kept at all times on hand shall be determined by the amount of deposits in all respects, as provided for in the said section

NOTE—Section 31 of "the national bank act" is incorporated in sections 5191, 5192, Revised Statutes. Section 1 of act June 20, 1874, precedes section 5133, Revised Statutes

NO RESERVE NEED BE HELD AGAINST DEPOSITS OF PUBLIC MONEY ACT
MAY 30, 1908

123 SEC 14 That the provisions of section fifty-one hundred and ninety-one of the Revised Statutes, with reference to the reserves of national banking associations, shall not apply to deposits of public moneys by the United States in designated depositories

PROVISION FOR REDEEMING CIRCULATION—FIVE PER CENT REDEMPTION
FUND ACT JUNE 20, 1874

124 SEC 3 That every association organized or to be organized under the provisions of the said act and of the several acts amendatory thereof shall at all times keep and have on deposit in the Treasury of the United States, in lawful money of the United States, a sum equal to five per centum of its circulation, to be held and used for the redemption of such circulation, which sum shall be counted as a part of its lawful reserve, as provided in section two of this act, and when the circulating notes of any such associations, assorted or unassorted, shall be presented for redemption, in sums of one thousand dollars, or any multiple thereof, to the Treasurer of the United States, the same shall be redeemed in [United States notes]. All notes so redeemed shall be charged by the Treasurer of the United States to the respective associations issuing the same, and he shall notify them severally on the first day of each month, or oftener, at his discretion, of the amount of such redemptions, and whenever such redemptions for any association shall amount to the sum of five hundred dollars, such association so notified shall forthwith deposit with the Treasurer of the

United States a sum in United States notes equal to the amount of its circulating notes so redeemed. And all notes of national banks worn, defaced, mutilated, or otherwise unfit for circulation shall, when received by any assistant treasurer, or at any designated depository of the United States be forwarded to the Treasurer of the United States for redemption as provided herein. And when such redemptions have been so reimbursed, the circulating notes so redeemed shall be forwarded to the respective associations by which they were issued, but if any of such notes are worn, mutilated, defaced, or rendered otherwise unfit for use, they shall be forwarded to the Comptroller of the Currency and destroyed and replaced as now provided by law. *Provided*, That each of said associations shall reimburse to the Treasury the charges for transportation and the costs for assorting such notes, and the associations hereafter organized shall also severally reimburse to the Treasury the cost of engraving such plates as shall be ordered by each association respectively, and the amount assessed upon each association shall be in proportion to the circulation redeemed, and be charged to the fund on deposit with the Treasurer. *And provided further*, That so much of section thirty-two of said national-bank act requiring or permitting the redemption of its circulating notes elsewhere than at its own counter, except as provided for in this section, is hereby repealed.

NOTE—Section 12 of act of May 30, 1908, provides that notes of national banking associations shall be redeemed in lawful money of the United States. (See said section 12, page 49, ante.)

Section 32 of national bank act is section 5195, Revised Statutes.

We may now contrast with the requirements which are thus laid down by existing national-bank legislation those which are established in the proposed legislation. In the following tabular view is given for each class of national banks—central reserve city, reserve city, and country—the provisions which it is proposed to create under the new legislation.

Reserve requirements

COUNTRY BANKS

	Up to 14 months	14 months to 36 months	After 36 months
	<i>Per cent</i> 12	<i>Per cent</i> 12	<i>Per cent</i> 12
Total reserve required			
Cash in own vaults	5	5	5
On deposit with Federal reserve bank required	3	5	5
On deposit in reserve or central reserve city or in Federal reserve bank or in cash optional with bank	4	2	
In cash or on deposit in Federal reserve bank, optional with bank			2
Total reserve	12	12	12

Date—"From and after the date set by the Secretary of the Treasury and officially announced by him as hereinbefore provided."

Refers to—"That within 60 days from and after the date when the Secretary of the Treasury shall have officially announced, * * * the fact that a Federal reserve bank has been established."

RESERVE CITY BANKS

	60 days	60 days to 14 months	After 36 months
	<i>Per cent</i> 20	<i>Per cent</i> 18	<i>Per cent</i> 18
Total reserve required			
Cash in own vaults	10	9	9
On deposit with Federal reserve bank, required		3	5
On deposit in central reserve city optional with bank May be cash or on deposit with Federal reserve bank	10	6	
On deposit with Federal reserve bank or in cash, optional with bank (see note)			4
Total reserve	20	18	18

Date—"From and after the date set by the Secretary of the Treasury for the incorporation of the Federal reserve bank"

Again—"For 60 days from the date set by the Secretary for the organization of the reserve bank"

BANKS IN CENTRAL RESERVE CITIES

	60 days	60 days to 14 months	After 14 months
Total reserve required	20	18	18
Cash in own vault	10	9	9
On deposit with Federal reserve bank Optional			
Required		3	5
On deposit with Federal reserve bank or in cash, optional with banks	10	6	4
Total reserve	20	18	18

Two questions present themselves in connection with these reserve requirements—the first, How far would the banks be able to comply with them without sacrifice, and the second, How far would this change seem to be desirable? These may be dealt with in the reverse order

In outlining the general philosophy of the proposed banking bill it was pointed out that the existing system of redeposited reserves gives rise to cheap money for stock-exchange speculation in the centers while it fails to provide in times of panic a reserve upon which the country can draw with assurance, because at such times stock-exchange securities can not be easily liquidated, so that call loans are unavailable as a resource, and the city banks in self-defense have deemed themselves warranted in suspending specie payments. It is contended, however, that these difficulties and irregularities of the existing system are mere blemishes upon the surface of an otherwise desirable state of affairs, and that there is good and sufficient economic

reason for maintaining the present system of redeposited reserves at least in part. This claim may be reduced to a series of propositions, as follows:

1. The redeposited reserves are placed with the city banks not for stock speculation, but in large measure at least to supply exchange funds upon which the depositing banks may draw.

2. The redeposited balances must be kept with the banks which now hold them, because the country banks look to these city banks for accommodation and the latter gauge the amount of accommodation to be granted them by the size of the balances.

3. The country banks, and in general all banks making the redeposits get a rate of interest thereon. They are thus able to make use of a reserve which would otherwise be "dead," and which when held in cash or in the Federal reserve banks will yield them no revenue, the latter banks being forbidden by the terms of the bill to pay interest on deposits. These contentions are worthy of careful study, because they are widely urged.

Regarding the first point—the question of exchange funds—it will be noted that the proposed bill has met the requirement for such funds by specifically directing Federal reserve banks to receive specified classes of checks at par. It has thus largely wiped out the necessity for any such balance as now held. It may be noted, however, that there is in the bill nothing whatever to prevent the banks from maintaining any amount of such balances with city banks as they desire. Clearly if the balances with the city banks are exchange balances they are not reserves and there is no reason for regarding them as such.

The second point already noted has even less force than the first. Not only does the proposed bill provide more extensive facilities for rediscount than have ever been known, but even if it did not do so, and even if, as alleged, there are many kinds and classes of security not eligible for rediscount under the bill which country banks can use as a basis for accommodation only with city banks, it would still remain true that this does not afford any warrant for demanding the maintenance of the existing situation. The refusal to grant accommodation except in proportion to the amount of balance held by the would-be borrower is purely a matter of business practice. If a condition should be created under the proposed bill such that banks could not maintain the present reserve city deposits, it is hardly to be expected that the reserve city banks would immediately injure themselves and destroy their own source of business profits by refusing

to buy good marketable paper or to extend loans upon sound security merely because conditions had altered and the large balances of former days were no longer kept with them

As for the third contention—the loss of interest to depositing banks due to the sacrifice of their 2 per cent on reserve balances—the argument against the proposed change almost degenerates into absurdity. The measure so greatly broadens the scope of banking business as to open many new avenues of profitable investment, while the sacrifice of the 2 per cent now customarily paid is not only no loss to the community but represents the abolition of a long-standing evil which has drawn funds to places where they were not needed and away from those where they were.

In the ultimate analysis, the whole question simmers down to an issue whether the amount of reserve prescribed under the proposed bill is or is not excessive, and whether it can or can not be readily furnished by banks under the terms of the suggested legislation. The existing system is not backed either by the custom of other countries, by abstract logic, by the dictates of past experience, or by any other considerations. The only problem in the case is that of determining the correct amount of reserves to be required by the banks, and then of making the transition to the new basis under proper conditions.

The next step in the study of the proposed requirements is therefore an analysis of the ability of the banks to make the transition. The following computations may first be examined.

1 The bill provides in section 20 for a revision of the existing reserves of national banking associations.

2 The present reserve system recognizes three classes of banks: (a) Country banks, (b) reserve city banks, (c) central reserve city banks. Country banks are required to hold 6 per cent of their deposit liabilities in lawful money and may hold 9 per cent in balances with other banks. Reserve city banks are required to hold $12\frac{1}{2}$ per cent of their deposits in lawful money and may hold $12\frac{1}{2}$ per cent in balances with other banks in central reserve cities. Central reserve city banks are required to hold 25 per cent of their deposits (including those of other banks with them) in lawful money in their own vaults.

3 The bill aims to transfer these reserves away from banks other than those to which they belong, so that ultimately bank reserves will be held partly (a) in the vaults of the banks to which they belong and (b) partly in the reserve banks to be created under it, the reserve banks thus created taking the place of existing reserve city and central reserve city banks in their relation to others.

4 In carrying out this plan, the bill contemplates that ultimately reserves shall be as follows (a) Five per cent of the outstanding deposits of all banks to be carried in the new reserve banks, (b) 5 per cent of the deposits of present country banks to be carried in cash in their own vaults, (c) 2 per cent of the deposits of present country banks to be carried either in cash in their own vaults or as a balance with new reserve banks. (d) 9 per cent of the deposits of present reserve city and central reserve city banks to be carried in cash in their own vaults, (e) 4 per cent of the deposits of present reserve city and central reserve city banks to be carried either in cash in their own vaults or as balances with the new reserve banks

5 It is of course evident that the "balances" spoken of can be obtained by rediscounting paper with the new reserve banks

6 From the foregoing it is clear that as some discretion is left to the banks about their reserves, the exact position of those reserves at any given time can not be predicted. Maximum and minimum limits can, however, be fixed. This is done as follows

7 At the date of June 4, 1913 (comptroller's last report), the present bank reserve in central reserve cities was \$409,601,424, held in cash

At the same date the reserve which would have been required under the new plan as above sketched would have been 9 per cent of net deposits then subject to reserve requirements in cash and 9 per cent as a maximum in balances with the new reserve banks, as follows.

To be held in cash	\$141,127,835
To be held as balances	141,127,835
Total	<hr/> 282,255,670

From this it is clear that if the balances under the new plan were established by taking actual money and putting it in the reserve banks the actual release of cash as compared with the present plan would be the difference between the total new reserve and the present reserve, while if the reserve balances were created by rediscounting the cash released under the new plan would be the difference between the cash required to be held under the new plan and the cash now actually held. That would signify

Maximum release of cash	\$268,473,589
Minimum release of cash	127,345,754

8 At the same date mentioned above the banking reserve in reserve cities as held by the banks was

Held in cash	\$250,383,926
Held in balances	232,799,679
Total	483,183,605

Under the new plan these banks would have to hold in cash 9 per cent of their net deposits subject to reserve requirements and a like amount in balances (maximum), which would be for the reserve cities as a group

To be held in cash	\$175,128,701
To be held in balances	175,128,701
Total	350,257,402

Comparing these figures with the present requirements, as already given, it is seen that the new plan might mean either a

Maximum release of cash	\$75,255,225
Or a maximum contraction of cash	99,873,476

9 At the same date mentioned above the banking reserve in country banks was held as follows

Held in cash	\$289,392,177
Held in balances	310,689,129
Total	600,081,306

Under the new plan the cash required would be 5 per cent of their net deposits subject to reserve requirements and 7 per cent in balances (2 of this at the bank's discretion) This would mean

To be held in cash	\$180,533,642
To be held in balances	252,747,100
Total	433,280,742

On the same principles as before this would mean a maximum release or contraction as follows

Maximum release	\$108,858,535
Maximum contraction	143,888,565

10 Thus it appears that there would be a possible maximum contraction as follows

Reserve city banks	\$99,973,476
Country banks	143,888,565
Total	243,862,041
Deduct central reserve city release	127,345,754
Net contraction	116,516,287

It is also evident that the result might work out as follows

Released by central reserve city banks	\$268,473,589
Released by reserve city banks	75,255,225
Released by country banks	108,858,535
Total	<hr/> 452,587,349

11 Which of these results would probably be reached? Assume that the first (contraction) was the net result owing to banks fulfilling their reserve requirements by depositing cash in every instance. The Government balances which are now to be poured into trade channels through the new reserve banks will run from \$200,000,000 to \$250,000,000. Bearing in mind the fact that the capital of the new banks has to be raised in cash, it will be seen that allowing for \$100,000,000 of this capital the monetary situation would be left about the same as it is to-day except that the new reserve banks would be in position to add their loaning power to that of the older banks. If we now assume that the transfer of reserves resulted in the extreme limit of expansion already referred to, it would be noted that the cash is released only on the assumption that the new reserve banks have to hold one-third in lawful money in order to make these discounts, it is clear that only two-thirds of \$452,587,349, or about \$300,000,000, will be released. Of this sum a certain part would be needed in bringing the reserves of State banks which may become members of the new associations up to the level which is required of them. How much this would be can not be positively asserted.

12 If it be asserted that this process will lead to inflation, the answer to be made is that whether it will or not is a matter in the hands of the reserve banks which have it in their power by fixing their rate of discount suitably to prevent the banks from creating with them, by rediscounting, reserve balances in excess of the required 5 per cent. If the reserve banks should do this, it would be found that the required 5 per cent referred to would be about \$356,000,000 while the amount which the banks at their option might or might not obtain in this way would be about \$213,000,000, the actual cash required to be held by them under the new plan as already sketched, being as follows

Central reserve city banks	\$141,127,835
Reserve city banks	175,128,701
Country banks	180,533,642
Total	<hr/> 496,790,178

Add to this the amount which the reserve banks can at their option

make it worth while for the other banks to hold in cash or to deposit with them in cash, and we have a total of about \$710,000,000. The actual cash held to-day by the banks at home and in the redemption fund is about \$950,000,000. Something like \$240,000,000 would thus be released under the probable working out of the system, and this would be drawn upon for the other purposes already referred to.

IMMEDIATE SHIFTING OF FUNDS

This review of the reserve requirements of the proposed bill is, however, based entirely upon a comparison of the situation as to reserves at the present time contrasted with the situation which will exist at the end of three years after the measure has gone completely into operation. It was deemed wise to allow this length of time, as has already been elsewhere noted, for the reason that there will necessarily be some readjustment of loans, and if the change were to be suddenly made it might result in temporary embarrassment for some banks. The committee has made very careful inquiry into the length of time that should be allowed for shifting reserve requirements in the way indicated, and the maximum period that has been asserted to be necessary was found to be three years. It is probable that the change could be effected in a very much shorter time than this, if it were necessary to bring it about more quickly, but the committee has deemed it best to allow the full period that was thought desirable by the most conservative reasoners whom it consulted. This three-year period was the maximum mentioned either in the public hearings or in communications sent to the committee by experts with reference to the subject.

There is, however, another phase of the question of transfer which has not yet been dealt with. A review of the reserve section will make it clear that a period of 60 days after the creation of the reserve banks is fixed, during which conditions are allowed to remain as they are if desired by city banks, but by the end of which it is required that a certain transfer of reserves shall have been made to the reserve banks. Inasmuch as it was thought that this transfer might be difficult for the banks unless they were granted relief to a corresponding extent, the bill provides for the reduction of the reserve requirements in reserve and central reserve cities from 25 to 18 per cent at the end of the 60-day period in question. An examination of the latest returns for banking condition made public by the comptroller as of June 4, 1913, and reproduced in the appendix of this report shows that the total net deposits subject to reserve requirements may be taken for

purposes of discussion at \$7,200,000,000. Three per cent of this amount is \$216,000,000. This might be supplied either through actual transfer of cash from the banks which now hold it, or through the obtaining of rediscounts, or partly in one way or partly in the other. The committee, however, has endeavored to adjust the requirements of the bill so that the transfer could be made, as already stated, in actual cash without any inconvenience. The reserve banks of the central reserve cities have normally on hand about \$400,000,000 of reserve money. Of this seven twenty-fifths would be released under the provision for reduction of reserves from 25 per cent to 18 per cent. Banks in reserve cities have normally about \$250,000,000 in cash, and about an equal amount in balances with central reserve cities. The reduction of reserve requirements from 25 to 18 per cent would release seven twenty-fifths out of this amount, or $3\frac{1}{2}$ per cent in balances and $3\frac{1}{2}$ per cent in cash—roughly speaking, \$70,000,000 in each form.

Now, let it be assumed that the banks undertake to comply with the requirement of a transfer of 3 per cent of their liabilities from existing reserve city and central reserve city banks to the new reserve banks. As an extreme illustration we may suppose that the country banks will draw for the amount in question on the reserve city banks. As the deposit liabilities of the country banks are about \$3,600,000,000, it may be supposed that the call will require about \$108,000,000. How would the reserve city banks supply this amount—assuming that the call was made upon them and not directly upon central reserve city banks? Presumably they would draw upon their New York correspondents, and upon other central reserve cities, unless by so doing they cut down the balances there below the figure necessary for them to hold in order to comply with reserve requirements. We have seen that they could spare only about $3\frac{1}{2}$ per cent of their own outstanding deposits. It must be remembered, however, that they will themselves find it necessary to shift 3 per cent of their outstanding deposits to the reserve banks. In addition, then, to the total draft of \$108,000,000 made upon them by the country banks, they will have to provide in order to meet their own requirements 3 per cent of about \$2,000,000,000 or roughly speaking \$60,000,000—a total requirement therefore of \$168,000,000. Of this it is fair to suppose that $3\frac{1}{2}$ per cent of their present deposits or fully \$70,000,000 can be directly transferred in cash without damaging their position. Another \$70,000,000 can be clipped from their balances with central reserve cities without unduly reducing the latter. There would thus be needed \$28,000,000 to meet all demands in cash.

In connection with the foregoing computation, it should, however,

be borne in mind that 1 per cent of cash has been released in the country banks by the reduction of the vault cash requirements from 6 to 5 per cent. Inasmuch as the total reserve requirements of country banks is cut to 12 per cent, it may perhaps be fair to suppose that this margin of cash could be drawn upon at the very outset in order to supply cash requirements. It would certainly before long furnish a means of extending discounts and would be available as a cash resource for the combined banks obviating the necessity of applying to the new reserve banks for rediscount accommodation.

It must, moreover, be borne in mind in the foregoing computations that by the process of withdrawing funds already referred to there has been a corresponding reduction of deposit liabilities, with a corresponding reduction of reserve requirements against them. For example, if the assumption that country banks draw upon reserve city banks for the full amount of their transfers to the new Federal reserve banks be correct, the effect would be to eliminate about \$100,000,000 of deposits formerly held by reserve city banks against which reserves had to be carried but which having been paid off are no longer subject to reserve requirements. This would be a release under the new reserve provisions of \$20,000,000 of reserve money in the reserve cities. The reserve thus released might be either in cash or balances and it is fair to assume would be about evenly divided between the two. In central reserve cities if a draft for \$70,000,000 were made by reserve city banks the result would be a release of reserve against deposits to a corresponding extent, thereby enabling banks to reduce their necessary cash holdings by one-fifth of that amount, \$14,000,000, at the outset and by a further 2 per cent additional later on.

Summing up these compensating or offsetting factors of the situation it is a fair conclusion that the draft upon the banks during the first 60 days' life of the new undertaking would be much less, so far as reserve requirements are concerned, than the demands made by present reserve requirements.

What has been said applies entirely to the first year under the new measure. At the end of that time an additional transfer of 2 per cent of deposit liabilities must be made by the member banks. Assuming that their deposits remain stationary during the year on the basis of the report of June 4, last, the amount needed to be transferred would be 2 per cent of about \$6,900,000,000, or about \$138,000,000. If the banks had not accumulated cash during the year or retained the surplus cash set free at the outset, this requirement might, so far as it consisted of an actual draft upon reserve and central reserve cities, have

to be met by rediscounting. There is, however, no probability that any such situation would develop. On the contrary, the year's operations would have been marked by a far greater ease in the loan transactions of the banks than any previously experienced, due to the fact that the new reserve system was in operation. It is fair to suppose that the amount of deposits would have increased considerably and that the amount of reserve to be transferred would have correspondingly increased. That in the meantime the habit of resorting to the reserve banks for rediscounts would have grown up can not be questioned. At the end of the year, therefore, the banks would simply be obliged to strengthen their balances with the reserve banks to the extent of \$138,000,000, and they would do this through ordinary commercial processes involving no inconvenience or sacrifice whatever. If the extreme supposition that the banks did not enlarge their deposits during the year, and that the cash originally held against them remained stationary, should be accepted, the fact would remain that the reserve banks would during that period have received some \$200,000,000 from the Government in cash deposits and would have paid out more or less of it, into circulation, inevitably resulting in increasing the flow of cash into the vaults of the member banks while they would still have a comfortable margin left from the first release. If the volume of loans were the same at the end of the year as at the beginning it would be practically inevitable that they should be very much stronger in cash than they are at present.

In closing this discussion of the relative strength of the banks before and after the transfer of reserves, it is well to emphasize once more the fact that the new requirements, far from causing constriction, will cause relaxation and that the danger of the situation from the banking standpoint will not be in the limitation of loans but rather in the inflating of them—a process which, however, will remain well under the control of the reserve banks to be organized, by reason of their regulation of the rate of rediscount.

Throughout the foregoing computations, it should be understood, reference has been had to the most unfavorable conditions that could be supposed to exist and no effort has been made to put the situation in a light that would present the transition to the new system as unduly easy. There are two broad classes of considerations which, however, should be taken into account in studying the situation which would exist after the adoption of the proposed bill. These are as follows:

1. Many banks do not keep their permitted balances with banks in reserve cities, but with banks in central reserve cities. The result is

that the total amount of drafts to be made upon reserve city banks will, in fact, be less than that which has already been computed and there will be less necessary shifting of balances under the operation of the bill in question

2 It is not true that all banks would as assumed come into the new system within 60 days. The act is founded upon the provision that (a) within 90 days after the adoption of the act the organization committee shall designate places for the organization of reserve banks, and that (b) within 60 days after the date when the organization of a bank has been announced, there shall be a shift of a certain per cent in the reserves required. This would be a total of 150 days after the passage of the act which would be likely to elapse before the new reserve requirements would become effective. More important still, the new reserve banks can be organized in any district as soon as a capital of \$5,000,000 each is assured. This would be \$60,000,000 in all, so that even if reserve banks were simultaneously organized in all districts it would not be necessary for more than three-fifths of the banks to have signified an intention to enter the system. The banks are given a year within which to settle for themselves whether they will enter the system or not. It is thus entirely possible, although we think not probable, that the organization of some of the reserve banks might be deferred until several months after the adoption of the act. If this should be the case the call for new reserves would be even slower and it is fair to assume that the movement of banks into the system will practically be distributed throughout the year so that the draft on reserve funds will not fall suddenly as has been assumed in the computations made above, but will be diffused over a very considerable period. This would give ample opportunity for the acquiring of reserve money through any one of the channels through which it is ordinarily obtained—importation, production of gold, the gathering in of cash in circulation, or as a substitute the gradual extension of rediscounts by Federal reserve banks which count for reserve purposes the same as actual cash, up to the specified limit permitted by the act. There need therefore be no anxiety whatever with reference to a sudden stringency due to an excessive demand for currency consequent upon a rush of banks into the new system immediately after the enactment of the proposed legislation. On the contrary, the reasonable expectation would point in the opposite direction—toward a somewhat extensive relaxation of cash requirements due to the fact that banks will see a profit in getting rediscounts from the Federal reserve banks instead of fulfilling their reserve requirements by transferring actual

reserve money to such banks. This is quite opposed, we are aware, to the current view on this subject, but it is far more in harmony with the facts of the case.

SECTION 21

In this section provision is made for the repeal of portions of existing law which require that the 5 per cent fund deposited with the Treasurer of the United States by national banking associations for the purpose of note redemption shall be counted as part of the lawful reserve. There is no good reason for treating the 5 per cent fund in this way and there never has been any. The existing requirements of legislation practically withdraw the amounts kept with the Treasury for the purpose of current redemption of national bank notes from the actual uses of the bank and put them out of reach. It is believed that if the national banks are to continue to issue notes, and so long as they do, they should be required to provide for the redemption of their notes on an independent basis, and that the fiction of counting as reserve something which is not reserve and never can serve that purpose ought not to be maintained. As the national-bank notes are retired, through the presentation of 2 per cent bonds for conversion into threes, the amount of the fund kept on deposit with the Treasury for the current redemption of national-bank notes will be of less and less importance, so that such burden as is thrown upon the banks by the provisions of section 21 will disappear as the banks at their own option convert their bonds. The section is therefore a further working out of the ideas carried by section 20, which are in substance that reserve should be either actual cash at home or a balance with a cooperative institution which is organized for the purpose of maintaining and safeguarding the solvency of the country and which can be relied upon to hold its balances subject to call in case of necessity.

SECTION 22

Section 22 establishes a reserve of $33\frac{1}{3}$ per cent of the outstanding demand liabilities of each Federal reserve bank, such reserve to be held in gold or lawful money. In a general way the committee believes that requirement of a fixed reserve is not a wise or desirable thing as viewed in the light of scientific banking principle. It believes, however, that in a country accustomed to fixed reserve requirements the prescription of a minimum reserve may have a beneficial effect, and it therefore has determined upon $33\frac{1}{3}$ per cent. This it regards as a minimum requirement and it firmly believes that the reserve banks will

of their own accord keep as a usual practice considerably more than the amount required. It will be remembered that in an earlier section (sec 12) the Federal reserve board was given power to suspend reserve requirements for 30 days if it saw fit. And in the present section, with that in mind, it is provided that if, upon notice of 30 days after being directed by the Federal reserve board to make good its required reserve so as to bring it up to $33\frac{1}{3}$ per cent, any Federal reserve bank fails to comply with directions, the Federal reserve board shall have power to close the bank and appoint a receiver therefor.

SECTION 23

In section 23 it is sought to improve upon and strengthen existing bank examination requirements, in the belief that the latter are not now sufficiently effective and that existing authorities have not the power to carry through such examinations either with the thoroughness or the frequency that the circumstances demand. Section 23 therefore provides for a change in the method of compensating bank examiners and alters in various details the methods now employed in carrying out the examinations.

In view of the close and intimate relationships which are to be maintained between Federal reserve banks and their member banks, and in view of the fact that the Federal reserve banks are authorized to act as clearing houses for such member banks, the power is bestowed upon the Federal reserve banks subject to the oversight of the Federal reserve board to carry on examinations of member banks as it may deem best. These examinations would be similar to those now conducted by clearing-house associations.

Paragraph 3 of the section authorizes the Federal reserve board to make an examination not less frequently than four times a year of national banks in reserve cities. This is in view of the fact that the reserve cities, if they continue to be such, will have the power of holding bank funds and of conducting all of the functions they now perform. It has been found in the past that the condition of city banks changed much more rapidly than did that of country banks, and it is therefore thought to be desirable that specially close oversight should be maintained with regard to this class of banks.

It has been complained that under this section national banks in reserve cities would be under examination nearly all the time. No charge of the sort can be sustained. The Federal reserve board's examinations of banks in reserve cities, which are to be made four times a year, are not additional to the two examinations of every

national banking association described in the first paragraph, but include them. In other words, banks ranked as country banks are to be examined at least twice and all others at least four times a year by the Federal reserve board, while, if desired, the reserve bank of each district may have a system of its own for keeping advised of the affairs of member banks—a plan employed by clearing-house associations to-day. The specifications with reference to the items to be shown in the reports of examination of national banks in reserve cities cover items that have been, it is thought, neglected under past legislation.

In general the purpose of this section is to convey all reasonable and necessary power of bank examination, to place it where it can be most effectively used, and to assume that the power is to be used for the purpose of strengthening, protecting, but certainly not of annoying or crippling the banks to which it is applied.

SECTION 24

In this section it is sought to correct a bad practice, all too prevalent, of paying fees to bank examiners in order that they may make a favorable report upon the condition of a bank, and further to end the illegitimate practice whereby officers of national banks have heretofore profited at the expense of borrowers by charging a commission or brokerage for the obtaining of loans. The extent of these practices can not be stated, but that they prevail is certain, and it is equally clear that they are opposed to public welfare and to sound banking, besides being wholly at variance with honorable personal conduct.

SECTION 25

In this section it is endeavored to overcome the practice which has sprung up on the part of dishonest or cowardly national bank stockholders of evading the double liability provision when they have been informed of the failure of a bank in which they hold shares, by transferring such shares to some "dummy" who is immune from recovery under the double-liability provision. It is believed that by making stockholders who have transferred their shares 60 days before a bank failure equally as liable as if they had not made such transfer, the needs of the situation will be met. Some have alleged that the requirements should be that stockholders be liable whenever and so long as it could be proven that they had knowledge of the impending bank failure, but that they should not be liable if in good faith they transferred their shares within 60 days before a failure. This sounds plausible but is at variance with the facts of experience. The process of prov-

ing that a stockholder had knowledge is difficult and expensive, if not impossible in many cases, and it is believed that the 60-day provision is entirely equitable and far more workable

SECTION 26

Loans on improved farm lands are provided for in this section under strict limitations as to the value of the security and the amount of the loan as compared with the face of the bank's capital. The loans are limited to a period of twelve months, and are permitted only in the case of country banks. This provision has not been made, as seems to be supposed in some quarters, for the purpose of furnishing a means of supplying farmers with working capital. It has been made upon the advice of practical bankers, in recognition of the fact that in many parts of the country the principal or almost the sole business of national banks is found in making loans to farmers, and that while these loans are in every sense commercial in that they are to be paid back out of the proceeds of a business process then going on—the raising and marketing of a crop—the only actual security the farmer can offer is a lien upon his land and its products. To allow the bank to take this lien enables it to do frankly and truthfully, with due protection to itself, business that it will probably do in some way, even if not thus authorized, inasmuch as the well-being of the community and the transaction of its business calls for the extension of loans to farmers who are engaged in the process of growing and marketing consumable articles and who need working capital in order to facilitate their operations. The total amount of such loans which could be made under the provisions of this section might run as high as \$150,000,000, but is not likely to approximate that sum.

SECTION 27

Permission to national banks to open departments specifically designed for the reception of savings deposits and conducted with a view to the separate investment and protection of such savings deposits is granted in section 27. For a long time national banks have found their business encroached upon by the growth of savings banks and trust companies, and in several hundred instances they are now found evading the law by the organization of allied concerns which are carried on as trust companies or savings banks under technically separate organization, but really under an identical control. The committee, while strongly believing in the principle of a corps of commercial closely restricted banks as the basic element in the country's credit

system, believes that with the added strength afforded by the new Federal reserve banks, Congress may reasonably relax some of the restrictions now surrounding the business of national banks and allow to national institutions the savings bank and limited trustee functions recognized in this section without unduly straining the essential structure of the national banking system, provided that savings departments if organized shall be conducted upon an entirely separate basis from the commercial departments of the national banks creating them, with segregated reserves and strictly segregated assets. Some further restrictions have been laid down in the section which are largely self-explanatory.

SECTION 28

There has long been a demand for an extension of the powers of national banks which would permit them to facilitate foreign trade and do business abroad. The plan upon which the committee has determined after much consideration and comparison of various competing propositions calls for permission to national banks having a capital of \$1,000,000 or over to establish branch banks in foreign countries whenever they may deem best, subject to regulations to be prescribed by the Federal reserve board. It is, however, required that due application shall be made to the reserve board for permission to establish such branches and that in establishing them the bank in question shall set aside a specified amount of its capital for use at the said branches and shall submit to suitable examination of the affairs of the branches. A separate accounting system is ordered to be maintained at each branch in order that it may be known exactly how successfully each such independent institution is being carried on, and in order to prevent unsuccessful operations engaged in at one point from being covered up in the affairs of the institution as a whole. Inasmuch as the requirements concerning the creation of these branches are necessarily general in terms, section 28 naturally specifies that a power of further regulation from the administrative standpoint shall be lodged with the Federal reserve board in order that the said board may exercise a suitable control over the doings of the banks which apply for such permission, and of their branches.

SECTION 29

Section 29 was merely the usual provision for repeal of inconsistent statutory requirements, whatever they may be, that might conflict with the terms of the legislation now proposed for adoption.

CHAPTER XVI

THE HOUSE DEBATE

Caucus Discussion

In ordinary circumstances the next step to be taken in advancing the proposed act toward the statute books after leaving the Committee on Banking and Currency would have been that of consideration in the House of Representatives. Owing, however, to the fact that during the later years of Republican control of Congress there had sprung up what was considered an obnoxious system of autocratic power in the lower chamber, exerted by the Speaker supported by a small group of leaders organized as the Rules Committee, Democrats had adopted the plan of acting in party caucus upon all measures of major importance. The purpose of this plan of action was that of insuring a general consideration of pending measures with all members of the party present or at all events entitled to be so. The plan had its merits but was also vitiated by certain obvious objections. Among these was the danger that demagogic members might, during the consideration of a complex or technical bill, mislead their colleagues into mistaken positions. This danger was conspicuously present in connection with a measure as complex as the Federal Reserve Act.

In accordance with the existing custom, the proposed bill was taken up by party caucus of the Democratic members of the House on September 11 and 12, the discussion lasting two days. Although no published record of the proceedings has been issued, the various motions and ballots taken during debate were recorded in a journal report and are accessible. In a general way, the caucus developed the existence of three

principal points of view among the members of the Democratic party. In advocacy of the bill there appeared, under the leadership of Chairman Glass and the administration group of Democrats, a strong body of members who desired to give the measure a pro forma ratification, thereby placing the party squarely behind it and transferring the discussion to the floor of the House of Representatives, although in that case with a tacit obligation resting upon the members of the caucus to support it. A second group in the party included the southern and western elements formerly grouped under the leadership of W. J. Bryan. They were not opposed to legislation as such, but believed that this particular bill had been drafted for the express purpose of depriving, or at all events in such a manner as indirectly to deprive, the farmer of banking assistance. It was their desire to obtain modifications of the bill which should result in concessions to the farmer and should accordingly modify the measure in the direction of popular interest. A third group of members was on the whole opposed to legislation of any kind either because they suspected that they might thereby be used as catspaws for the "financial interests," or because they doubted the wisdom of any measure at the moment.

Lines of Division

With the division lines thus drawn it was to be expected that the principal elements of controversy would appear in arguments from the Conservatives on the one side and the Bryan Democrats on the other, the third or doubtful element remaining practically silent and ready to throw its vote to one or the other of the two groups already described, according as circumstances might make it desirable to do so. Notwithstanding that there had been repeated efforts to arouse the jealousy and suspicion of Mr. Bryan during the period of deliberation in committee, these efforts had been notoriously unsuccessful, the Secretary of State after his understanding

with the administration confining himself to generalities or, in so far as he used his influence at all, applying it strictly within the inner circles of the party. The term "Bryan Democrats" in so far as employed in the congressional debate was therefore an historical appellation, having no reference to the contemporary leadership of the group. Such leadership had, in fact, vested largely in Representative Henry of Texas, a disciple of the early Bryan school of currency thought, who was convinced that the Secretary of State did not mean what he said in his indorsement of the new banking measure.

Argument of Radicals

The principal burden of Mr. Henry's argument and of that presented by others who supported him was that the Federal Reserve Act was essentially a disguised form of the Aldrich bill, and that it would play into the hands of the money power by enabling the bankers of the city to obtain the use of funds belonging to country bankers which the latter ought for the welfare of the people to keep at home and to employ in local loans. Failing, however, in the effort to induce the party to return the bill to the Committee or to modify it so extensively as to transform its character, Mr. Henry was disposed to center his attack upon the conditions under which rediscounting was done for member banks. His effort was to broaden the underlying eligibility requirements of paper in such a way as to secure greater length of maturity and more liberality for the notes and bills to be presented by member banks for discount. The term "corn tassel currency" jocosely applied to Mr. Henry's proposed modifications grew out of the fact that had his suggestions been adopted they would have permitted the issue of federal reserve notes (which were to be government obligations) upon a basis which might have amounted to little more than that furnished by stored agricultural products. In general the argument of those who supported the Henry plan was largely directed to showing that, owing to the pecu-

liarity of his industrial requirements, the farmer was in no position to provide the kind of paper which was designated as eligible for rediscount at the reserve institutions

Real Provisions of Act as to Notes

This argument of course entirely ignored the fact that under federal reserve machinery it was not expected to be necessary that specific classes of paper should be eligible for discount in order that their owners might obtain accommodation at reserve banks. On the contrary it had been kept in view all through the discussion of the act that what was needed was to provide a satisfactory basis of liquid paper which should be eligible for discount, thereby enabling member banks to get accommodation which they in turn could dispense to their customers, although not necessarily through the rediscounting of the particular items of paper offered by the latter. The later working of the federal reserve system amply bore out this intent or plan, making it clear that in many cases member banks find it more convenient to borrow upon items of paper which they are holding for that specific purpose rather than to inconvenience a borrower by compelling him to remould the conditions of his loan, or its maturity in such a way as to present a perfect case of eligibility. Member banks, in short, are not middlemen or retailers who dispense credit which they have bought at wholesale from reserve banks, nor are they mere indorsers placing their names upon the paper of customers in order to discount it. They are banks and as such obtain banking services from the reserve organization which supplies them what they need under given restrictions, while they in turn make advances to their customers as the latter need. This, however, was perhaps too complex a view for the Democratic opposition to consider, even had they been less blinded by partisan feeling. They did not therefore hesitate to urge the ~~amendment of the bill~~ along lines which would permit a very much greater latitude in rediscount.

Favorable Caucus Report

The reporting of the bill by the Democratic caucus, practically in the shape in which it had been completed by the Banking and Currency Committee, virtually insured an early and favorable vote upon it in the House of Representatives. So large was the Democratic majority that the possibilities of serious opposition or even of lengthy obstruction on the floor were very small. The authority of the caucus system was still new and powerful so that even those who were unfriendly to the measure were disinclined to impair their party standing by renewing their opposition upon the floor. There was little to be expected therefore in the way of an intraparty discussion, that having been practically disposed of during the caucus consideration, while the formal discussion between members of the two parties was, for the reason just stated, certain to lack vitality.

It shortly appeared that these considerations would insure the adoption of the measure exactly as it stood even without the use of parliamentary devices to protect it. Interest in the debate therefore centered around the attitude to be assumed by Republican members, and such interest was itself more vital as applying to the future than as affecting current conditions, since there was in fact nothing that Republican opponents could do. Moreover, one good effect of the banking controversy during preceding years had been that of eliminating or mitigating purely partisan or interparty controversies about general banking questions. The discussion of the Federal Reserve Act once more demonstrated this condition and made it appear that even a measure which had been matured and pressed under such exclusively Democratic auspices as had the Federal Reserve Act might none the less be expected to get support from the more enlightened members of the opposition.

Such antagonism to the new law as was displayed by the Republican party in the House in fact centered to no small degree about details. A minority of the Banking and Cur-

rency Committee, consisting of the Republican members acting practically as a unit, had opposed the bill on the ground that it produced too high a degree of centralization, granted too extensive powers to the Federal Reserve Board, and put the government too extensively into the banking business. It was a curious fact that among those who were thus inclined to harp with somewhat tiresome reiteration upon the great powers of the Board was a member who himself later became a member of the Federal Reserve Board and as such an urgent defender of the powers bestowed upon it over his protest.

Mr. Lindbergh's Attitude

More interesting than the rather forced and formal objections to the measure registered by the old line Republican majority of the Committee was the objection filed by Representative Charles Lindbergh of Minnesota, who at the time had become known as a tireless critic of the Money Trust. Mr. Lindbergh, although a "Progressive Republican," found himself unable to join with his colleagues of the regular wing of the party, and whereas they confined themselves to criticism upon details, he himself took issue with the entire proposal. Mr. Lindbergh was thus in substantial harmony with the extreme left wing of the Bryan Democrats, although no formal junction had been effected by him with that political group.

The floor debate reflected practically the lines of discussion which had thus been foreshadowed in committee, and produced but little in the way of contribution to banking theory or knowledge. A number of speeches more or less carefully prepared in advance were successively fired off to small audiences in the House, the only ones, however, which received serious attention being the elaborate and careful address of Chairman Glass himself, the opposition remarks of Representative Henry, and a scattering fire of criticism from Mr. Lindbergh and his sympathizers. Nowhere throughout this debate could there be found any cross-fire of argument.

upon points of technique or of general banking theory. Although the groundwork for such a discussion had been laid by Chairman Glass in his opening address, and although abundant opportunity was thus afforded for a thoroughgoing discussion of the main principles involved, it was evident almost from the outset that the membership of the House was not prepared for such work. There was evidence here and there of disposition on the part of some member or group to voice the views of country bankers opposed to par clearance or to support Mr. Henry in his attitude of opposition to the rediscount provisions, but in the main the whole discussion was parochial and narrow. Perhaps the most striking thing about it was the fact that, as clearly appeared from a review of the different addresses, the organized banking interests opposed to the bill had practically determined to yield the day in the House. Indeed, it was well understood that their legislative advisers had arrived at the conclusion that the House organization was too strong for them and that the battle had better be waged practically entirely in the upper chamber. Banking and other interests therefore which aligned in opposition frankly took the position of regarding the action of the House of Representatives as a mere prelude to the real consideration of the legislation.

Debate on Details

Detailed discussions of the bill had been begun on Monday, September 15. Section after section was taken up in succession. Amendments offered by the Committee, practically all of a merely technical nature altering the wording, were usually accepted,¹ while such amendments as were offered by the opponents of the bill were almost uniformly rejected. These amendments were generally in line with objections

¹ The words "subscribing banks," "shareholders," "shareholding banks," and "subscribers," used interchangeably in the original bill, were altered by amendments throughout the bill to read "member banks," and the word "capital" was substituted for "capital stock."

raised in previous caucus debate, and were intended to alter the fundamental principles of the bill, or deprive it of its essential features wherever possible by a change of wording, an additional clause, or a "striking out" amendment

An essential change of this kind in Section 1 was offered by Mr Lindbergh. In this it was sought to have the subscription of member banks lowered to 10 per cent of capital and surplus. Mr Lindbergh pointed to the injustice which otherwise would be inflicted upon the smaller banks, especially in agricultural communities, and called for the distribution of the assessments, whatever they might be, over a longer period of time. Mr Hayes (Republican) and Mr Phelan (Democrat) defended the viewpoint of the Committee, and the amendment was lost. Defeat also met an amendment offered by Mr Morgan, who desired to add a provision allowing individuals to subscribe to the stock of the reserve banks. Mr Madden proposed to reduce the number of reserve banks from 12 to 5, to permit state banks and trust companies to become members, and to eliminate the compulsory character of the measure by providing that banks "may" become members instead of being compelled to. Vigorous support and proposal of an amendment by Mr Mondell did not help Mr Madden's proposal.²

Mr Madden sought to alter Section 4 so as to take from the Board the power to decide who shall manage the reserve banks and its power to remove directors. His amendment was lost, as was a proposal offered by Mr Platt, limiting the removal power of the Board so as to require the consent of the other directors. Mr Mondell wanted the whole clause pertaining to the removal power struck out, but his substitute to that effect as well as the original amendment was lost.³

² Sundry amendments to Section 3 originated in the Committee and were of a merely technical nature, unifying the language throughout the bill in regard to the words "subscriber," etc.

³ When the discussion on these points was interrupted by Mr Murdock, who drew the attention of the House to the fact that not more than about 100 members were attending these sessions whilst a measure of such momentous nature was acted upon, an attack on the caucus method ensued, since it, as its critics maintained, made it impossible and therefore unnecessary to introduce any alterations against the decisions of the majority.

Mr Lindbergh offered an amendment designed to prevent interlocking directorates, to which Mr Glass replied that such a provision had been omitted because it was thought that it did not pertain to a bill of this kind. The amendment was lost. Another proposed amendment to Section 4 related to the salary of federal reserve agents which one member thought ought to be fixed by an authority other than the body which appointed to the office, he therefore desired to provide in the bill for a definite compensation.

Sections 5 and 6 were subjected to merely technical alterations by amendments of the Committee. The reading of Section 7 was followed by a discussion on the taxation of the federal reserve banks, Mr Temple expressing his apprehension that Congress would divest itself of its taxing power by delegating it to the Federal Reserve Board. When Mr Morgan's amendment providing that surplus earnings should be spent "in constructing and to promote and encourage the improvement of public roads"⁴ was lost, he offered a substitute, that they should be utilized to establish a fund for the guaranteeing of bank deposits. This, like the preceding amendments, failed.

Discussion on Sections 8 and 10 occurred on Tuesday, September 15. Mr Towner offered an amendment to Section 8 providing relief for the dissenting stockholders of a national bank who did not desire to enter the new organization. In line with his proposal of the previous day Mr Mondell was for striking out that part of the section which pertained to the dissolution of any national bank not complying with the provisions of this act within one year.

Conditions of Membership

Mr Young offered an amendment to Section 9 of the bill in which he sought to do away with what he considered an injustice to a great number of bankers who had not sufficient capital to entitle them to become members of the sys-

⁴ Record, 63rd Congress, 1st session, p. 4995

tem but on the other hand must be regarded as the very banks which have occasion to use credit It was lost

Section 10 was subjected to much criticism A large amendment was offered by Mr Murdock, which included the banking reform recommendations made by the Democratic members of the Pujo Committee It contained the prohibition against consolidation of banks unless such consolidation had been approved in the public interest by the Comptroller—a prohibition against interlocking stockholdings amongst banks and against the creation of a voting trust In replying to Mr Murdock, Mr Glass referred simply to the statement of Mr Samuel Untermyer who, in his capacity as attorney of the Pujo Committee, had expressed an opinion against the linking of legislation on these matters with the proposed banking and currency measure Mr Helm, who was for the adoption of the amendment when voted upon in the caucus, considered himself on that account especially qualified to state the reasons which had convinced him of the opposite He said

I am one of those who, after taking sober second thought, have come to the conclusion that it would be unwise to hit the country with the tremendous jar that would be inflicted upon it if all the legislation that is required to be enacted to put an end to this evil were put into this bill⁵

Opposition to Government Participation

Mr Thompson, by moving to strike out the last three words, obtained the floor for the purpose of putting on record his dissenting attitude as to some features of the bill He recognized the caucus method for the sole purpose of determining a party policy He was against the fundamental principle of the measure which in his opinion created a partnership between the government and the banks

If the central reserve bank is a good thing, I submit that

⁵ *Ibid.*, p 5003

the capital stock of the bank should be subscribed entirely by the Government, and all the profits should go to the benefit of all the people of the United States ⁶

After dwelling upon the needs of a rural credit system Mr Thompson finally concluded with a declaration of his belief in the principles of the Democratic party. It was not until after another argument on merely partisan ground and a debate on the rules of procedure, in particular as "to striking out the last word,"⁷ that the discussion turned back to the original point at issue, Mr Murdock's amendment. Mr Buchanan, although a Democrat, did not see himself bound by the caucus resolution which voted down the amendment as regards interlocking directorates in view of the fact that the Democratic platform of 1912 had declared itself in favor of a law prohibiting it ⁸

Status of State Banks

Mr Lindbergh proposed an amendment similar to a previous proposal, namely, to omit that part of the section on membership which referred to the non-admission of a bank to stock ownership when not entitled to become a national banking association. His thought was to admit the country banks with a capitalization of less than \$25,000. Mr Mondell urged an amendment designed to restore the principle of free banking, which he thought in danger in view of the fact that it was in the discretion of the Board to admit or exclude state banks. Both proposals were lost. However, before the debate on Section 10 came to a conclusion Mr Mondell seized another opportunity of raising protest against the compulsory feature of the bill by reason of which the measure, as he maintained against Mr Glass, differed essentially from the Aldrich bill.

On reading Section 11 relating to the Federal Reserve Board, Mr Manahan of Minnesota offered an amendment in-

⁶ *Ibid*, p 5009

⁷ *Ibid*, p 5013

⁸ The vote on the amendment registered 61 noes against 43 ayes

Section 15 was taken up on September 17 Mr. Lindbergh offered an amendment, striking out the clause authorizing the establishment of agencies of federal reserve banks in foreign countries for the reason that he thought it sufficient that national banks were allowed to do domestic branch banking business, asserting it was dangerous to divert funds of the reserve banks, which included government funds, to foreign countries. Mr. Phelan and others pointed to the necessity of developing foreign trade and the amendment was lost.

Note Issue Provision

Section 17 on the note issue brought forth amendments from all the several critics of the fundamental principles underlying this provision. Mr. Platt wanted such changes as would make the notes distinctly bank notes, so also Mr. Willis, who further wished to limit the issue to the amount of \$500,000,000. Messrs. Towner and Fess were for the redemption of the notes in gold, Mr. Temple pointing, besides, to the danger of adding to the reserve not only gold but also lawful money, which would make the base for expansion of credit much larger than a reserve of gold only. The argument led to a long discussion on the question whether the provisions of the section would impair the gold standard or not. Critics of the provision maintained that in effect it repealed the Law of 1900 which provided that United States obligations should be redeemed in gold. "If they are not intended to repeal that provision of law," said Mr. Mondell, "why do you use the words 'lawful money'?"¹⁰ Mr. Hardy took the opposite ground, contending that the Law of 1900 was not repealed but that the section simply permitted banks to redeem the notes in lawful money for which (the lawful money being kept on parity with gold) gold can be had at the Treasury. The words "lawful money" proved to be the main stumbling block in the discussion and the opponents re-

¹⁰ *Ibid*, p. 5075

refused to admit any reason for inserting them if the gold standard was to be maintained. Mr. Fess offered an amendment for inclusion directly in Section 29 and in which he provided that nothing in this act should be construed to repeal the parity provision of the Act of March 14, 1900. This the Committee promised to take under consideration, since upon it depended the acceptability of the whole bill (according to Mr. Fess) in the minds of all those who feared an impairment of the gold standard under its terms. This amendment bearing upon the parity provision contained in the Act of March 14, 1900, found some strong opponents amongst the ranks of the Democrats, who did not want to commit themselves to the gold standard. Opposition also came from the side of those who did not admit that the present bill was interfering with the Act of 1900. But Mr. Phelan pointed out that the amendment was acceptable for the very reason that it was to clear up an implication carried in the bill, and did not represent a change. This latter view was eventually maintained by those who did not want to be bound by the caucus and was accepted.

Section 25 was criticized because it modified the liability of the stockholder of a national bank, who was, under the old law, equally and ratably liable for the amount of his own stock, while the existing law would hold one stockholder liable for another.

Farm Loan Provisions

Some Committee amendments to Section 26 on farm loans were accepted. Mr. Burke saw in it a discrimination against the real estate owner in favor of the farmer and wanted therefore the word "farmland" replaced by "real estate." Mr. Lindbergh was for extending the loan period to 5 years and increasing the loaning power on farm land from 25 to 50 per cent of capital and surplus. Both amendments were lost.

On September 18 the bill finally came to a vote. On motion of Mr. Wingo a separate vote was taken on the much

disputed amendment to Section 29 relating to the gold standard, which was carried by a large majority. The bill itself passed the House by 287 yeas against 85 nays¹¹

Letters of Approval

The passage of the bill in the House was a great personal triumph for Mr Glass. The scope of the victory thus won was attested by the following letter written by the Secretary of the Treasury

THE SECRETARY OF THE TREASURY

Washington

September 20, 1913

My dear Glass

I want to congratulate you sincerely upon your really great achievement in the passage by the House of Representatives of the Glass Bill to reform the currency system of the country. It is a measure upon which you have done so much tedious, intelligent, and effective work that I can well understand your gratification now that the worst of your labors is over.

You are, more than any other single man, entitled to the credit for this real victory in the cause of the people of this country, and your name will always be linked with the first constructive financial measure passed by Congress since the enactment of the National Banking Act. You have led the fight with singular ability and with a high order of statesmanship. I am only too glad to have the opportunity of paying this just tribute and of telling you, as well, of the great pleasure and satisfaction it has given me to be your earnest, although not always effective, colaborer and coadjutor in this needed measure of vital reform.

Always, with warm regards, I am,

Sincerely yours,

(Signed) W G McAdoo

Hon Carter Glass,
Lynchburg, Va

¹¹ A few days after the House had passed the bill, Mr Howard of Georgia took the floor to present a scheme which he had worked out in regard to the refunding of 2 per cent government bonds. In connection with the postal savings system he provided a plan by which the bonds could be taken up and absorbed by the people at large. In issuing them in small denominations, they could be utilized as evidencing the postal savings deposits, so that a man who had a deposit in the postal savings bank would thereby become a purchaser of a government bond. "The use of a coupon obligation as an evidence of deposit would offer to the depositor facilities for collecting both his

Colonel House, whose earlier attitude has been elsewhere reviewed, telegraphed as follows

BEVERLY MASS SEP 18TH 1913

THE HON CARTER GLASS

HOUSE OF REPS WASHINGTON D C

PLEASE ACCEPT MY CONGRATULATIONS AND FELICITATIONS OVER THE PASSAGE OF THE CURRENCY BILL IT IS A BRILLIANT ACHIEVEMENT AND YOU DESERVE THE THANKS OF YOUR COUNTRYMEN

E M HOUSE 335P

A New Aspect of the Issue

The conclusion of the House debate and the favorable vote, involving as it did a substantial element of support from among the depleted Republican membership, put a new face upon the federal reserve proposal. It made the banking issue stand out as a foremost problem of the moment. It gave force and point to the expressions already attributed to the President and setting forth his determination to get action at an early date. It quite changed the alignment of interest in the banking world, since there had been many who still believed that the work that was being done in the House was little more than a piece of political stage play. When the President announced that it was his intention to have the new measure taken direct to the Senate and acted upon by that body at an early date, the fact that the bill had already been adopted by one chamber and had won considerable prestige assumed a significance that could not be ignored. Not only the financial community, but the business world, was now fully aroused, and the discussion of the banking question began to assume an immediate and practical character which it had previously not had. In what has already been said of the attempt to influence the House Committee, it has appeared that

interest and principal, which can not be afforded under any other known system. It would encourage the great mass of the people to become holders of government securities in such amounts as they desired" (p. 5149). Under this scheme Mr Howard thought it reasonable to expect an accumulation of these funds equal to \$500,000,000 within 2 years and within a short time longer the amount would be far more than the \$750,000,000 long term government bonds which were then as well as now held by the national banks

the work done during June, July, and August proceeded chiefly from the larger interests and from the organizations which were directly concerned in getting some action from Congress. Thus far there had been small evidence of practical interest on the part of the country banks, while the business world at large had been apathetic. Conditions were now to change. Thus far the real severity of the contest about the bill had been found within the Administration and in the inner councils of the Democratic party. The scene of the contest was now to be transferred to a much broader stage and was to assume active proportions on a national scale. A review of some of the principal elements in the struggle is therefore necessary.

APPENDIX TO CHAPTER XVI

QUESTION AND ANSWER DOCUMENT ON FEDERAL RESERVE BILL

The following document received considerable circulation among members of the House during the course of the controversy on the pending measure.

POSSIBLE QUESTIONS RAISED BY BANKING BILL

1 Why allow ninety days for the work of the organization committee (section 2)?

Because elaborate inquiry must be made in order to ascertain the direction of bank business at the present time and the groupings of banks due to the necessity of business relationships as now organized. The banks having close relations with one another should be classified in the same districts. There are now no adequate statistics that could be used for the purpose of drawing district lines.

2 Why should there be 12 districts and 12 reserve banks?

It is desirable to have as many reserve banks as can be strong and successful institutions. It is not believed that any reserve banks should be organized with inadequate resources. If the probable joint capital of the reserve banks is \$100,000,000 this would mean an average capital of only about \$7,500,000. Some banks would be a good deal less than this figure. It is believed that 12 will furnish a sufficient number, but the way has been kept open for others in case of necessity.

3 Is it necessary to require banks to subscribe to the stock of the new institution?

Evidently the banks must be induced to come in on some basis if it is to be a bank stockholding scheme exclusively. The Aldrich bill tried to induce them to come in by holding out important inducements. The present bill aims to treat the banks fairly but seeks to end some bank abuses. It will therefore be opposed by many banks. They ought not to be allowed to defeat the scheme. The requirement that they come in is not unfair or onerous but merely means that if they want to be known as national banks they must participate fully in the national system.

4 Why is capital only half paid up?

So that there may be a double liability of stockholders upon the same plan provided in the national banking system.

5 Is it likely that the other half would ever be called?

Very unlikely. The requirement is hardly to be expected unless there should be disastrous losses by a federal reserve bank. These are believed to be out of the question. The banks may fail to make money but it is not likely that they will lose any considerable amount.

6 Why should Federal Reserve banks be allowed to establish branches when other banks are not?

Federal Reserve banks are under close Government oversight and do a restricted kind of business. They trade only with their stockholders and with the Government. Their branches are not organized for the purpose of competing with anyone or of getting new business but merely for the convenience of the public.

7 What powers are given to Federal Reserve banks that are not possessed by national banks?

Only those of holding Government deposits and issuing federal reserve treasury notes. Other powers are identical with those bestowed on national banks except in so far as a difference in the kind of business to be done necessitates the adoption of a different method of managing or overseeing or carrying on such business.

8 How far would the Board of Directors of a federal reserve bank be exclusively a bankers' board?

As the bill shows bankers would have three representatives, business interests three, and the public three. There is no reason to doubt that the representatives of business interests who are appointed by the bankers would be essentially conservative men, familiar more or less with the local conditions of credit and with banking methods. While Government representatives would probably be more independ-

ent there is no reason to expect that in ordinary times there would be any more lack of harmony on such a board than on any board of directors. The fact that a majority of the members could be removed by the Government would, it is believed, prevent the taking up or suggesting of schemes which otherwise would make their appearance if the board were organized upon purely individualistic lines.

9 Is there danger that the mechanism provided for electing the local boards would prove clumsy?

Economists, among them Professor Sprague of Harvard, pronounced the machinery simple and ingenious. Others assert that it is far simpler than any other plan of the kind that has been placed before the public. There is no reason to expect any serious difficulty in carrying it on.

10 What would be the functions of the federal reserve agent in practice?

While he is designated as chairman of the board of directors of the federal reserve bank, it is probable that this function would be honorary rather than active. The agent would act as a means of communication between the bank and the reserve board at Washington. There is no reason to doubt that he would find his time fully occupied with the routine of maintaining the local office of the federal reserve board, attending to the issue and withdrawal of notes and other similar functions. He would have only a supervisory and informing function at the bank itself.

11 Why give the organization committee the powers of the chairman of the Board of Directors at the outset?

This is merely to make a beginning and enable the organization committee to summon meetings and so forth without repeating the specific authorizations given in the act to the reserve agent.

12 Is it not a hardship to provide that shares in the stock of reserve banks shall be nontransferable?

The effect is to tie up the member bank's subscription in a practically permanent form but this is thought necessary. The success of the scheme will depend largely upon the number and permanence of the banks that enter the new system. They should not be allowed to sell their shares or alienate them in any way if they are to continue actively interested in the success of the reserve banks.

13 Why should the Government receive any of the earnings of a reserve bank?

The Government gives the monopoly of note issue to the reserve bank and it enlarges the classes of business such bank can do very

much beyond the scope allowed them in the national bank act. There is every reason why such concessions should be paid for. It is believed that by giving the banks first an ordinary rate of interest on their investment and then making a division of earnings between them and the Government equity is secured as well as the best results in practice. To take all the earnings reduces the banks' incentive to get business, not to take any might lead to undue expansion in the effort to enlarge profits while it would allow the Government nothing for the exclusive use of the circulation power.

14. Why is a year granted national banking associations within which to decide whether they will take stock in a reserve bank?

A reasonable time is necessary to enable banks to prepare for the transition to the proposed plan. If a bank wishes to leave the system it should be granted opportunity to arrange for its transfer to the state system. It is true that this postponement may correspondingly delay the system in taking effect. It is not likely that it will do so, however, at least not to any considerable extent. Many banks will be anxious to organize and there is nothing in the act to prevent immediate organization provided that a reserve bank has a capital of \$5,000,000 at least.

15. What is the use of giving national banks the power to reorganize as is done in section 8?

This is in order that no doubts may arise as to the charter rights of national banks. It is desired to have all if possible recharter, thereby making their existence conterminous with that of federal reserve banks, and definitely fixing the relations between the national banks and such reserve banks.

16. Why should state banks be allowed to take stock in a reserve bank when they can as a matter of fact convert into national banks?

Many strong state banks will not care to give up their charters but if they comply with all essential provisions of the act there is no definite reason why they should not be allowed to do business with the Federal Reserve banks. The greater the number of existing banks that take stock, the more perfectly will the credit system of the country be organized and the more completely will the benefits of organization be secured.

17. Would the federal reserve board be a group of politicians?

In the sense that they are appointed by the President these members would be "political." The Comptroller of the Currency is a political appointee in the same way. So are members of the Supreme Court. The same is true of such bodies as the Interstate Commerce Commission.

18 Is there danger in entrusting the management of credit to "politicians"?

That depends on the politicians just as it would depend on the bankers. What opponents mean by this criticism is simply that they prefer to trust bankers in preference to public officers. Experience has not warranted any such preference and the objection is therefore thoroughly hypocritical, unless it is based simply upon a fear that the appointees would not be skilled in banking. That is a question to be settled by the appointing power, but in order to obviate any danger of ignorance, a federal advisory board is provided for. This board would be able to give advice on all points relating to banking since it would be made up of practical bankers familiar with local credit conditions.

19 Is it true that no competent man can be employed for \$10,000 a year?

Experience does not so indicate. Very few bank presidents or officers in the United States to-day receive more than that sum. Of those who receive more practically all started on very much less and have been less efficient since they reached the \$10,000 level than they were before that. The Government has constantly obtained the best ability for the salary mentioned. This is due to the fact that many other considerations beside salary control men in the selection of their work.

20 Why is the position of the Comptroller altered by section 11 (page 19, lines 13-23)?

Merely in order to make him directly amenable to the orders of the Federal reserve board, in order that that board may have a direct means of communicating with national banks. The change is purely administrative.

21 Is the power of the federal reserve board to compel rediscounts between federal reserve banks "socialistic" or "inquisitorial"?

These expressions are merely cant words currently used by those who do not like a given idea. The power suggested is infinitely less than that which would have been bestowed on the Aldrich central bank had that been created. Such a bank would have exercised this power all the time, by its transfers of funds among the several districts. There would be no doubt of the approval of the bankers of the country of this function if it were to be controlled by themselves. The bill however makes it purely an emergency power, and one that is not likely to be employed except at long intervals.

22 Is it not dangerous to allow the federal reserve board to suspend the reserve requirements?

This is practically what is done by the Comptroller today. Similar action is taken in foreign countries upon occasions. The suspension of the Bank of England act has similar effects. There is no probability that such suspensions would ever be made except on application and after due investigation.

23. Are there any other unusual or far reaching powers?

None whatever, in fact the federal reserve board performs simply administrative functions analogous to those of the Comptroller of the currency. The Comptroller's powers have been broadened and strengthened at some few points as the result of experience. The same would be done for the Comptroller himself, if the national bank act were today undergoing revision.

24. Is not the federal advisory council an unnecessary piece of machinery?

No, it will serve as a natural, useful, and legitimate means of communication between the federal reserve board and the several federal reserve banks. Without it communication would have to be carried on with each bank separately. It will serve as a useful means of developing public opinion and conversely of influencing it.

25. Why should it be assumed that the banks of the country will want to rediscount paper?

True they do not rediscount much today, but that is because of the restrictions of the national banking act and the individualized system of credit in the United States. Rediscounts will immediately spring into existence when countenanced by law. They will open a means of once shifting credit and resources from one part of the country to another and of harmonizing rates of interest. At the same time they will enable banks to earn more by making much more extensive loans.

26. What is meant by notes and bills of exchange growing out of commercial transactions?

The note is the ordinary promise of an individual to pay, while the bill is an instrument drawn by one man upon another directing the latter to pay at a specified date and when accepted by the latter becomes his obligation. Such notes and bills grow out of commercial transactions in the sense that they are incident to or are made for the purpose of carrying through such transactions. The restriction is necessary in order that such paper may not be admitted to rediscount when made purely for the purpose of artificially obtaining a loan or for carrying out some speculative operation. Paper of the latter class should and should be excluded from rediscount not necessarily because there is anything wrong in its creation, but because there being no

commercial transaction behind it there is no assurance that it will be paid at maturity

27 What is meant by an acceptance?

An acceptance is merely a bill of exchange that has been accepted by some one—that is which some one has agreed to pay. The peculiar feature about the acceptance mentioned in section 14 is that it is a banker's acceptance. Ordinarily there is no reason why a banker should accept a draft on him payable otherwise than at sight. It is supposed to be his function to meet all claims on demand. The banker, however, may be induced by one who desires credit to guarantee the latter's paper, which he does by accepting it—that is, agreeing to pay it at maturity. This means that the real borrower undertakes to protect the banker at the maturity of the acceptance, while the acceptance itself is an accommodation arrangement establishing a contingent liability on the part of the bank. The effect of it is to make the market for the credit broader, in proportion as the banker who accepts is better known than the borrower at whose instance he has accepted the paper.

28 What is the purpose of the so-called market operations in the bill?

These are intended to serve two purposes (1) that of facilitating transfers of funds and (2) that of making a discount rate effective. A federal reserve bank might have a considerable amount of fluid resources and yet might not be able to get them into circulation by reason of the fact that the constituent member banks were not borrowing freely from it. If it be given the right to buy paper in the open market, it is in a position to make its bank rate effective, in a way and to an extent otherwise not feasible.

29 Why should Government deposits be made with Federal reserve banks exclusively?

These banks are in better position to handle the affairs of the Government than any private banks can be. Moreover the Government shares in the profits of the bank after the stockholders have received a moderate rate of interest. There is every reason why these banks alone should be the depositaries. As for the question of depositing at all, it is well settled that the existence of the present Treasury system has been a great mistake. No other country has anything like it. It withdraws funds from circulation when they are needed and is likely to put them back when they are not needed.

30 Will the note issue provided by this act be elastic?

Undoubtedly it will. It will be put out as rediscounted paper

comes into the federal reserve bank's vaults and will be diminished as such paper is paid off at maturity. Meanwhile there will be an active redemption of the notes because they are not available for use as bank reserves.

31 Is this a real Government issue?

It is in the sense that the Government has full supervision of it and can refuse to let it go out at all, except when needed, in the sense that the Government has absolute authority over its existence since it can tax it out of existence, and since it can take the profits on the circulation for itself by insisting upon an adequate rate of interest before it will let the notes go out.

32 Why should provision be made for redemption of checks and drafts at par?

In order to furnish an absolutely uniform and stable credit currency all over the country. There is the same reason for this that there is for par redemption for bank notes or government notes. It is true that such redemption will "save money" to some persons to a greater extent than to others. But it will save the public so much annoyance and inconvenience and unreasonable expense that the action is most important.

33 Is it true that the bond sections of the act give the banks a "bonus" of 1 per cent?

The bond section merely provides for paying the 2 per cents at par, when they mature. If in the meantime banks want to give them up the Government will exchange them for 3 per cents, to a limited extent each year. This is equivalent to a purchase of the circulation privilege for 1 per cent. As the Government can get through a rate of interest on notes issued or through the increase in the earnings of federal reserve banks, very much more than this 1 per cent, it is safe to say that every \$1,000 of notes retired through the exchange of bonds (thereby making an equivalent void to be filled by new reserve notes) will be the most profitable business investment the Government could possibly make.

34 Is it true that the reserve requirements of the bill will cause inflation or contraction?

The reserve requirements have been figured with extreme care and will ultimately result in a somewhat less cash requirement than at present. The idea of stringency is ridiculous as the result of the reserve requirements. It is a fact that the reserve sections will release some cash—just how much cannot be positively asserted. Full control over this cash is, however, placed in the hands of the reserve banks them-

selves and a proper discount policy on their part will prevent any inflation whatever

35 Is the reserve for federal reserve banks sufficient?

Experience abroad shows that it is probably about right There is every reason to expect, however, that the federal reserve banks will be conducted upon a sufficiently large principle to keep very much more reserve if circumstances should indicate the desirability of such a course A fixed reserve is serviceable only as a guide to the small and relatively weak bank or the bank that is not operated under the best management

36 What is the truth about the statements that the bill will cause severe suffering and may lead to panic?

These are the statements of bankers in central reserve and reserve cities who want to keep the money that has been sent to them under federal compulsion in the past for the purpose of stock speculation or of enlargement of their own profits Thus far they have made no well grounded or legitimate objections to the general principles of the measure Some country banks have been induced to pull the chestnuts out of the fire at the instance of these larger bankers or because they are afraid to lose the 2 per cent interest they now get on their deposit balances, neglecting the fact that the new bill opens many avenues of legitimate profit closed heretofore

CHAPTER XVII

OPPOSITION CAMPAIGN OF THE BANKERS

Currents of Banking Opinion

No thorough understanding of the present currency and banking situation in the United States is possible without a clear definition of the attitude of the American banking public toward the subject. This attitude is not clearly understood by the majority of citizens. Some are disposed at times to regard the banking profession as practically a unit on all subjects, and to view it as having special interests of its own, sometimes referred to as embodied in what is known as the "Money Trust." Analysis shows that the American banking public is by no means harmonious in its interests, except in so far as is true of all who are concerned in maintaining the stability of prices and values. Nothing has been done by united banking action, save occasionally on minor points, and at periods when important legislation was under consideration the financial community has been peculiarly inharmonious in its views and opinions. The American Bankers Association and the state bankers' associations have in recent years done much to bring about a certain amount of prevailing unity of feeling and to insure the observance of standards of professional ethics which without them might not have existed. At times when controverted issues were under discussion, they have applied discipline and brought recalcitrant members 'into line,' and have thus secured action to an extent that would otherwise not have been possible. This work on the part of the various bankers' associations has been in a large measure beneficial to the community as a whole, and undoubtedly highly

beneficial to the banking community as such. It has not, however, always been intelligent and has at times, as is likely to be true of the work of all such associations, been vitiated by selfishness.

However, many representatives of bankers' associations have been in the habit of representing them as at all times strongly devoted to the cause of "sound money," "banking reform," and improvement of currency, notwithstanding that there have been few occasions in American history when there was any general consensus of opinion as to the meaning of these vague terms. The years of discussion which produced the Federal Reserve Act were no exception to this rule, and while it was true that various bankers' associations at times appeared to be strongly united in support of the Aldrich, or Monetary Commission bill, whose history has already been reviewed, it was probably never the fact that a real consensus of opinion even on that subject existed. There were many features of the so-called Aldrich bill which antagonized the small bankers of the country, and many the wisdom of which some of the abler and more conservative bankers doubted. The apparent support which was yielded to it by the banking community was undoubtedly the result of a general opinion that nothing would be done without at least a reasonable showing of harmony, and that the bill in the form in which it had been offered would at least constitute a forward step, its demerits, whatever they might prove to be, being left for later correction. Due to the fact that this relative measure of harmony had been evolved as the result of agitation and discussion during a period of years, the Federal Reserve Act found itself confronted by what appeared to be a very strong and united opposition to its progress.

Inactivity Explained

The position of the banking community with respect to the adoption and operation of the Federal Reserve Act was

necessarily recognized from the very beginning as a matter of the utmost importance. It has been seen how at an earlier date Chairman Glass had attempted to sound conservative banking sentiment for the purpose of ascertaining whether it was not possible to obtain a consensus of opinion which would permit the preparation of a generally satisfactory and acceptable measure, and it was noted at that point how unsuccessful was this endeavor. In a later chapter it was also shown how bankers, when invited before the House Banking and Currency Committee had stood firmly for the Aldrich bill and had taken the position that they could under no circumstances indorse a measure of the kind which, they were given to understand, was in process of preparation. The close of the session of Congress which came to an end on March 4, 1913, undoubtedly marked an era of encouragement on the part of the banking community in the belief that nothing was likely to be done. They had, it would seem, been advised that in the new session there was no plan for anything outside of the tariff discussion and they undoubtedly regarded this as deferring any further consideration of the matter until the opening of the winter session in December, 1913, by which time it was well recognized there might be an entirely new aspect to the political situation. What they did not count upon was the fact that President Wilson, with his usual insight, had grasped the fact that a remarkable opportunity for action had offered itself. The months of March and April were thus a quiescent period in banking discussion, the view being frequently expressed that legislation was so far in the future that no heed need be given to it. From this point of view there was a sharp change when rumors began to reach the financial interests that the President really intended to force action upon banking.

Banking Opposition

Opposition, too, had been steadily offered from the very initiation of the bill by the various organizations and asso-

ciations of citizens who were in large measure dominated by the greater banking interests. From the opening of the work on the Federal Reserve Act it had been recognized by skilled legislators that the ability to secure the passage of the measure was open to the gravest doubt. Not only the divisions within the Democratic party itself, but also the natural differences of opinion to which reference has already been made and the difficulty of getting a complex financial and economic problem before the country in any satisfactory way, offered themselves as serious obstacles to advancement in the work. Recognizing that such was the case, it had been thought wise by Chairman Glass at a comparatively early date to ascertain whether the banking and affiliated interests were sufficiently open-minded to reconsider the whole question of a banking measure, and whether if such a measure could be framed in a way that would afford reasonable and proper protection to the legitimate banking interests at the same time that it sought to correct the evils which then existed, they would support the measure, or at least refrain from opposing it. This question was accordingly placed before representatives of some of the principal groups which had been urging banking reform in the autumn of 1912. The matter was apparently carefully considered and a reply rendered through the president of one of the large national banks of New York who had been active in the cause of bank reform.¹ This reply was absolutely opposed to any support of a new banking measure. It was plainly stated that the banking interests and those who were affiliated with them had definitely determined upon the Aldrich bill. They were willing that this bill should be camouflaged or disguised in any way that legislative managers might see fit, but they insisted that the contents of the Aldrich bill down to the minutest element should be reproduced in the pending measure. For the

¹ The matter referred to was discussed by the author with the banker in question during October, 1912, and effort was made to ascertain what the general attitude of the financial interests would be toward a new measure. This was done with the approval of Chairman Glass and the results were duly reported to him.

attainment of this object they had already spent large sums of money and devoted infinite time and pains, and this they believed themselves able to accomplish through the manipulation of the legislative machinery

Views of Currency Commission

It was not, however, a sufficient investigation of the attitude of the bankers merely to present inquiries of this sort to an unofficial, however influential, person acting and speaking in an individual capacity. So soon, therefore, as the Federal Reserve Act had been carried to a slightly more advanced stage, it was determined to consult with an authorized representative of the banking interests as such, and accordingly a discussion of the subject was undertaken with Hon. A. B. Hepburn, then chairman of the Chase National Bank of New York and himself a former Comptroller of the Currency. The reason for selecting Mr. Hepburn was merely that he was at the time active in the work of the American Bankers Association and was the chairman of the Currency Commission of that association, a body formed for the purpose of considering and reporting upon all legislative proposals that might be offered. Mr. Hepburn was, moreover, a high-minded and public-spirited man, largely free from professional and sectional bias. At about the beginning of the year 1913, it was accordingly sought to obtain his opinion relative to the general problem of banking legislation, and to him was put somewhat the same question that had been framed in the earlier conversations already described. Mr. Hepburn was in effect asked: What is it that the bankers of the community essentially desire, what is the basic idea of their program? In effect the answer of Mr. Hepburn to this question was substantially as follows: The bankers desire to see a central banking system organized substantially along lines indicated by European experience, free of politics and conducted in the public interest. As for details, Mr. Hepburn was of the opinion that they were to be regarded

as details only and that whatever might be done, provided the measure contained the principal object in view as already stated, would be acceptable. Mr Hepburn was emphatic in his adherence to the Aldrich bill as the most carefully worked out and on the whole the most favorable measure presented.

Careful Analysis by Authorities

Mr Hepburn's expression of opinion was by no means the result of an individual or hasty reply. Although the whole discussion was carried on in conversation and was never committed to writing, he was careful to state that he had consulted with other members of the then Currency Commission of the American Bankers Association and that he believed that he represented their views in what he said. This general answer having been made, the question was placed before Mr Hepburn in so many words: If it be true that you desire a European central banking system, have you and your associates any objection to private (individual) ownership of the stock in the new banks, to direct transactions with the public, to the establishment of branches receiving deposits and making loans in direct trade with individuals and otherwise carrying on a banking business in competition with the banks already existing throughout the country? This question also was given very careful consideration by Mr Hepburn in consultation with some of his associates and his answer was emphatically opposed to general trading with the public. The bankers did not desire to see anything done that would bring about or permit this kind of competition, or, as they expressed it, would put the government further into the banking business. That being the case, it was necessary for him to modify his general statement that what was desired was a central banking system organized upon European lines. Such a system in fact was by no means what the bankers desired. They were willing to see the organization of a central banking system, but only upon condition that it should be confined to emergency uses.

Development of Opinion 1912-1913

The discussion of the general question of banking legislation continued more or less steadily throughout the winter of 1912-1913 among the more influential members of the banking fraternity throughout the United States, but there was probably always a hope that, in some way, it would be possible to prevent the undertaking of new lines of work such as had been suggested to them. The definite completion, however, of the Federal Reserve Act which had become quite generally known during the month of March, 1913, as already noted, led the bankers to feel that a time had come for some definite official action. Brief review of the situation in its political aspects has already been made, but more detailed consideration is now necessary. A committee of the executive council of the association, as already observed, called upon Chairman Glass in Washington just prior to the spring meeting at Briarcliff and on the following day held a consultation in New York at which the main outlines of the bill, so far as then developed, were stated to them.² Their attitude toward the Federal Reserve Act as then drafted was one of opposition—an opposition which took form in an ad interim report presented at Briarcliff and stating that the committee had obtained knowledge of the general outlines of the bill and had found it highly dangerous.

The attitude of the bankers with respect to the pending bill was not, however, very clearly defined up to about the time that the text of the first draft actually became public.³

² By the author, at the request of Chairman Glass.

³ That the Briarcliff meeting was followed by an organized though private effort on the part of the American Bankers Association or its leaders to check or antagonize the further progress of the Federal Reserve Act, seems highly probable, but there was no success in the matter and the first official step that became known was the meeting of the Currency Commission at Atlantic City early in June, at which time the whole subject was taken under advisement. The outcome of the Atlantic City meeting as described in the text was a further announcement in vigorous opposition to the adoption of the bill as framed in the form which had become known to bankers. Soon after this Atlantic City meeting the official introduction of the measure in the House and Senate occurred, and copies were at once widely distributed, while the press of the country found the measure a never ending theme of discussion. Immediate action on the part of local associations and groups of bankers ensued and members of Congress were steadily subjected to bombardment practically throughout the summer with arguments originating in banking quarters and designed to show the dangers of the proposed measure.

With the publication of the first draft a serious change occurred. The earliest newspaper publication of an authoritative sort on the subject took place, as already noted, on June 18. On that very day the Currency Commission of the American Bankers Association was holding a session in Atlantic City, having been called to that place by the chairman, Mr. A. B. Hepburn, for the purpose of considering the proper policy to be pursued by the organization with respect to the pending legislation. It has been seen that while no copies of the bill had been distributed to bankers, no secret had been made of the main elements of its provisions, but they had been freely discussed with all who had a serious interest in knowing how they were likely to be affected by the new measures. This kind of information was, however, limited to a comparatively small number of representative men, others waiting for the publication of the bill. The Atlantic City conference of the Currency Commission was held in executive session, but there was a general understanding that it had devoted itself to a consideration of the regional reserve plan in broad outlines. Each member of the commission had before him a copy of a list of questions relating to banking which had been sent out by the Senate Banking Committee and it was thought that the commission might best record its views on the whole subject by sending in an official set of answers to these questions. A set of replies, practically voicing the ideas of the Commission, was therefore transmitted to the Senate Banking Committee.

Committee of Bankers Visits Washington

Very much more important than these formal replies to questions was the determination to send a special committee to Washington to consult with President Wilson and Secretary McAdoo of the Treasury Department. It was understood that this committee would also consult with Chairman Glass, and that an effort would be made to obtain a joint session between the committee on the one hand and the President, the Secre-

tary, and the chairman of the Banking Committee on the other. The committee in question arrived in Washington about June 30 and immediately undertook a series of conferences which culminated in a session at the White House, participated in by the persons already enumerated. This was followed by a series of talks with Chairman Glass in private. The bankers in presenting their case to the President first sought to protest against government participation to so large an extent in the affairs of the proposed Federal Reserve Board. They desired that the bankers should be represented adequately upon the Board, even if they did not secure a majority of the members of that body. They were also restive with respect to the proposed participation of the government in the affairs of the local federal reserve banks, and especially with the proposed appointment of the federal reserve agent as chairman of the board of directors of the banks. They complained of the Treasury note section of the bill and were more than dissatisfied with the section relating to the refunding of government bonds. President Wilson in his remarks to the bankers confined himself largely to the relation of the government to the banks and made the broad statement that in no country in the world were the bankers allowed representation upon a government administrative body appointed to oversee the affairs of the institutions engaged in the practical transaction of business. So strongly did Mr. Wilson express this point of view that he thoroughly won over Chairman Glass, who up to that time had been doubtful about the wisdom of the proposed exclusion of the bankers from the Reserve Board. The President also by the cogency of his argument made a considerable impression upon the minds of the bankers, and when he suggested that they should take up the further and more detailed discussion of the measure with the Secretary of the Treasury and with Chairman Glass, they were much more disposed to do so than previously. In the subsequent consideration of the measure during the stay of the committee in

Washington they laid special emphasis upon the improving of the Treasury note section and the restoration of the government bond refunding provision. These were both suggestions that were in direct line with the views and wishes of Chairman Glass. The bankers, however, reiterated their desire for some representation in the management of the new system and, coming closer to the real question nearest their hearts, categorically demanded that a part at least of the existing reserves held with correspondent banks should continue to be so held under the new bill. They desired in this way to maintain the relationships between city and country banks and to insure to the former at least some portion of the balances that they were holding.⁴ Failing concessions on these points, the bankers told Chairman Glass they would fight the bill to the utmost.

Effort to Find Basis of Agreement

A day or two of consideration brought about a tentative agreement including the following points

- 1 A new section to be included in the bill providing for a Federal Advisory Council to consist of bankers and to consult with the Reserve Board
- 2 Permission to be inserted in the reserve section whereby at the end of the three-year period set for the transfer of reserves to the new bank, the Federal Reserve

⁴This committee first argued the whole question of reserve deposits with Mr. Glass, and finding him determined to retain the provision calling for the definite transfer of the reserve balances to the new federal reserve banks, finally compromised with him upon the agreement whereby there was to be inserted in the new bill a provision leaving the matter of such transfer entirely in the hands of the Federal Reserve Board and giving to such Board the power to rescind or revoke it at will. In return for this modification they undertook to withdraw opposition to the measure, or perhaps to give it a qualified support. It seemed to Chairman Glass that if any such agreement could be definitely made with the bankers there would be a possibility of greatly reducing the antagonism to the measure, and that the question of some such compromise was therefore worthy of consideration. Mr. Glass was firmly of the belief that the transfer of reserves would prove itself to be not only entirely free of any injurious effect upon the banking community but, on the contrary, highly beneficial, while he was unable to conceive of any Federal Reserve Board which would be so lacking in the knowledge of general principles of banking as to throw aside what was unquestionably likely to prove the most valuable and important change in banking organization that had been introduced since the Civil War. He therefore gave the bankers a tentatively favorable reply and proceeded to take the matter up with President Wilson. He found the latter, however, unexpectedly opposed to it. Nevertheless the President was indisposed to deny what Mr. Glass had partially agreed to and he therefore gave a somewhat unwilling assent to the proposal.

Board might, if so minded, permit 5 per cent of the deposits to be held as balance with a correspondent bank, such balance to count as reserve

3 The bond refunding section to be reintroduced

Bankers Agree to Support Bill

Subject to these modifications, the bankers finally undertook to support the Glass measure and, making a virtue of necessity, they worked up more than a little artificial enthusiasm with respect to it. President George M. Reynolds of the Continental and Commercial Bank of Chicago, just before leaving Washington, told Chairman Glass in so many words that he and one of his associates on the bankers' committee, Vice-President Solomon Wexler of the Whitney Central National Bank of New Orleans, were "enthusiastic" with reference to the measure. Mr. Glass prepared to make the changes desired in the bill, after obtaining from the President a very reluctant consent to this compromise. In fact, a draft of the bill containing certain of the changes agreed upon was printed. Mr. Glass, therefore, was considerably surprised to receive some three days after the departure of Messrs. Reynolds and Wexler a letter, dated Chicago, in which these two gentlemen repudiated their bargain and announced an intention of opposing the bill under all conditions. It is fairly to be assumed that after leaving Washington they encountered other bankers who encouraged them to believe that they could drive a better bargain than that to which they had already tentatively pledged themselves.⁵ In this, they announced their

⁵ It is of no little interest that the bankers who succeeded in making an impression upon the minds of members of Congress were representatives of the Chicago and middle western element among the national banks. New York bankers had from the first been extreme in their opposition and disinclined to discuss their case with Mr. Glass. Chicago bankers had in years past often acted as spokesmen for the New York interests, besides representing important interests of their own, and no doubt did so on this occasion. The fact that during the summer of 1913 they chiefly presented two points which they regarded as of fundamental importance showed that they really represented reserve city rather than western interests. The first was the modification of the provision as to transfer of reserve balances, the second, the status of their government bonds held to protect circulation. Some of them, in fact, frankly stated that if these two points, both of such fundamental importance to the city bank, could be properly safeguarded, they would offer no further objection to the enactment of the law no matter what it might contain.

determination not to assent to the reserve provisions as they then stood either in the projected bill or in the compromise form which had been worked out. The latter was equivalent to the announcement of intent to take their chances of securing the elimination of the reserve section on the floor, and was in its way therefore tantamount to a declaration of continued war upon the legislation.

Bankers Withdraw from Agreement

This communication was received with unfeigned relief and the resolution not to make any change in the reserve sections hardened, thus becoming the cardinal point in the new measure. Grave doubt had existed both in the minds of Mr. Glass and of all others who were closely conversant with the reserve provisions as to the wisdom of making a concession in any case, and it had been tentatively promised only after a good deal of question and uncertainty. The news that the bankers were not willing to stand by the tentative agreement was, therefore, acceptable and both Chairman Glass and the President regarded it as a happy relief from an undesirable modification of an essential provision in the measure. With the departure of this committee of bankers and with the announcement of their hostile attitude from time to time by bankers' associations and conventions, to which reference has already been made, a complete condition of warfare was finally established between the advocates of the Federal Reserve Act in Congress and the bankers themselves. A like condition was also developed as related to the citizens' associations so called, which had been seeking banking reform. The president of the National Citizens' League, probably the most considerable propaganda organization then in existence, had written offering in terms to repudiate the bill and the opposition of members of his organization continued to be developed in many ways throughout the summer and autumn. The New York group or element in the National Citizens' League, which had been

previously hostile to anything except the Aldrich bill, from the very beginning practically declared open war, its members employing all of the usual legislative stratagems and methods for the purpose of defeating the Federal Reserve Act in the Senate, or at all events of amending it back into conformity with the terms of the Aldrich measure

Carrying further the campaign against the Federal Reserve Act, the Currency Commission of the American Bankers Association determined to invite representatives of state banking associations, clearing house associations, and some others, to attend a conference at Chicago, August 22 and 23, "in regard to the Federal Reserve Act pending in the Congress of the United States" The conference was largely attended and included a number of men bearing names notable in American banking, the proceedings being subsequently published as "unanimously adopted" In calling the conference the Currency Commission recognized the banking measure then pending as "evidencing" the earnest wish of the administration to "give a wise law to the country" and represented itself as profoundly desiring to "co-operate in every way" Although the pending measure, said the conference, in its final report, had "many excellent features and recognizes certain principles fundamental in any scientific banking system," nevertheless the application of those principles "might in certain respects be made in ways that will more surely avoid a credit disturbance"

Restoration of Aldrich Bill Desired by State Banks

The ways which were recommended by the convention of state banks thus called were essentially nothing more than to amend it back into a rather close resemblance to the Aldrich bill Instead of reporting reasons for its position, the conference merely prepared a redraft of the measure as it then stood, indicating in red ink the omissions and additions which it proposed These changes were calculated to bring about

1. Curtailment of powers of the Federal Reserve Board and a limitation of its authority over the reserve banks
2. Restriction of government influence or authority in reserve banks, the federal reserve agent being deprived of his chairmanship therein
- 3 The making of national bank membership voluntary instead of compulsory
- 4 The withdrawal of the power to compel inter-reserve bank discounts
5. Withdrawal of power to interfere with existing reserve cities
- 6 Elimination of provision for the Federal Advisory Council
- 7 Complete elimination of the note issue section and substitution of a provision for plain bank note issue.
- 8 Elimination of par collection
- 9 Withdrawal of any requirement that member banks maintain reserve in federal reserve banks
- 10 Modification of the additional powers conveyed to national banks in respect to savings deposits

The recommendation of the convention had little or no effect. It was a thoroughly selfish proposal which would have stripped the reserve system of any real power to accomplish results, leaving it as a mere emergency expedient which might or might not at times have had some influence. Indeed, the conclusions arrived at were apparently intended only to satisfy all of the recalcitrant elements in the bankers' associations which were represented, and it is likely that the abler men who participated in this meeting would not if individually consulted have given their sanction to any such restricted proposal as this. The action taken therefore is significant merely as definitely placing on record the combined banking interests of the United States and of making it plain what would have been the result had Congress or the administration given heed to these counsellors.

Country Bankers' Demands

The effort of the bankers as embodied in the protest filed at the Chicago meeting was not, however, deemed sufficient. Its ineffectiveness was soon demonstrated and it was resolved to attempt to influence Congress through the country bankers of the nation. Accordingly a fresh conference was summoned to meet in Boston October 6, 1913, and there the whole question of the Federal Reserve Act, which had meantime been passed by the House and was pending before the Senate, was considered. The result was the adoption of certain resolutions which were transmitted to members of Congress by Hon. W. J. Bailey of Kansas, the presiding officer of the session. These resolutions were so remarkable and constitute so definite a statement of the position assumed by country bankers both then and since that they deserve reproduction as follows:

A banking and currency bill is now pending in the Congress. Its speedy passage into law is desirable. Any new financial system adequate to the needs of the nation must be one that country bankers, National and State, can support with justice to themselves as bodies corporate, and with justice to their customers.

Country banks, as distinguished from the banks in the fiscal centers, represent in number about 75% of all the banks in the United States. They bear the burden of national prosperity in proportion to their numbers. Legislation hostile to the welfare of these country banks is of necessity also hostile to the welfare of American citizens, whether farmers, wage earners or business men. A satisfactory banking system has long been needed by the people. Legislation upon this subject has already been too long delayed. The efforts of administration leaders at Washington to pass this statute at a special session is to be commended. Recognizing these facts, and having had no opportunity to go on record concerning this legislation, a large number of country bankers present at Boston, attending the Convention of the American Bankers Association, held a meeting on this sixth day of October, 1913, and the following resolutions were presented and adopted:

UNITED STATES BONDS

"1.—That government bonds have been purchased by country banks

at a price that would be unjustified except for circulation and depository privileges that attach to them. These bonds are now selling under par. The good faith of the nation and its credit must remain unimpaired. If national bank notes are to be retired there should be exchanged for these bonds a new security that will sell upon its own merits at 100 cents on the dollar in the markets of the world, and banks desiring to liquidate their circulation should be given the right to have their bonds retired at not less than their face value.

SEGREGATION OF SAVINGS DEPOSITS

"2—That any unnecessary restrictions placed upon the acceptance and investment of savings deposits is unwise. The prosperity of the people depends much upon the profitable use of their earnings. Country banks have always encouraged thrift on the part of their customers and others resident in their respective localities. Many millions of savings deposits have thus been created. In rural communities there is no need for separate savings banks. Banks doing a commercial business are now satisfactorily caring for this business. These deposits are safely loaned out at home. There is rarely any local market for bonds of any character. To require country banks to invest savings deposits in any one class of securities, to forbid their use for local farming and business needs, to divert this money from local to foreign purposes, will seriously cripple the credit of their customers and result in the very disaster which it is the aim of this legislation to prevent. Segregation of savings deposits, the setting aside of separate capital, the creation of two banks under the same management and under one roof, will place a burden upon country banks which they cannot bear, and will deny to their patrons facilities which they require and now enjoy.

EXCHANGE

"3—That section 17 of the bill should be so amended in so far as it refers to matters pertaining to exchange. We suggest that section 17, page 33, be amended by eliminating the last word on line 15, the first five words on line 16, the balance of the section after the 18th line, leaving the last paragraph of section 17 to read as follows:

"It shall be the duty of every federal reserve bank to receive on deposit at par and without charge for exchange or collections, checks and drafts drawn by any of its depositors upon any other depositor, and checks and drafts drawn by any depositor in any other federal reserve bank upon funds to the credit of said depositor in said reserve bank last mentioned.

"Exchange profits represent a large part of the total net earnings of country banks. It is a proper charge for a fair service rendered. The bill as now drawn will decrease the net earnings of the average country bank by not less than 25 per cent and many of them much more. This gain will not go into the pockets of the business men of America, but will be enjoyed solely by the banks of the collection centres which are now making satisfactory profits. The result of this section will be to take income from banks that can least afford the loss and give this money to banks already earning satisfactory profits.

"In addition to the above, the bill provides a radical change in the method of handling country items. It provides that they shall be cleared and not collected. To accomplish this it would require that the small country banks keep in the federal reserve banks an amount in excess of their legal reserve sufficient to care for their clearings from two to six days, depending entirely upon the distance and time they are from the bank acting as such clearing house.

RESERVES

"4—That whatever percentage of reserves is agreed upon should carry with it the right to keep not less than one-third of such reserve, with approved reserve agents in fiscal centres. The reduction of reserve from 15 to 12 per cent is no real advantage to the country bank. Very few country banks can do business without having a larger amount of funds either in vault or with nearby connections. These connections must be maintained after the passage of this law. The money so held by them should be counted as a part of country bank reserve.

THE BILL IN GENERAL

"5—That the above matters include only those features that country bankers are specially concerned with. There are others of equal importance which concern the larger banks in the fiscal centres. With these subjects we do not propose to express an opinion, but we believe that unless this bill is amended so as to meet the objection and recommendations made herein that very few country banks, either State or national, can afford to become members of the new federal system. This means that the great majority of country national banks must surrender their charters or retire from business.

"The exchange and savings sections of the bill so reduce our earnings that most country banks will show net operating losses, instead of the reasonable profits we now enjoy. We desire to do our full duty

to the country, but our duty to stockholders and customers must not be disregarded. We desire to become members of the federal system and assist in making it the success it ought to be and can be made. We earnestly call upon the Congress to consider this resolution as a formal expression of opinion on the part of country bankers, who realize the seriousness of the situation that now confronts them. And, finally, we ask for the committee that will present these resolutions to the Hon. Robert L. Owen, chairman, and the committee on banking and currency of the United States Senate, for an opportunity to be fully heard in the premises."

Bankers Association Acts

A more noteworthy meeting which clearly showed the position of the bankers was the regular annual session of the American Bankers Association at Boston which received and adopted a report from its Currency Commission, the substance of which was an attack upon the Federal Reserve Act and a demand for its amendment. The salient features of the report as thus presented were these:

The proposed legislation is still pending in Congress. The bill in its present form imposes unwise hardships upon the banks, and equally unwise hardships upon the general public. The interests of the bankers and commercial public are coincident, no injury can be inflicted upon the one without the other also suffering. When business is active and prosperous, the banker shares in the benefit, when it is languishing, he feels the ill effects. The chief function of a banker is to loan his capital and other resources to his customers so that they may increase the activity and extent of their business. Any withdrawal of the bank's capital from these legitimate channels of trade not only entails a loss to the banker, but also to the business public.

The banks are required to subscribe to the Federal reserve banks an amount equal to 20 per cent of their capital, one-half of which must be paid in at once, the other one-half being subject to call. This is to be taken over and placed under the management of a corporation in which the banks have not only a minority representation, but a very limited voice indeed. In return for the capital thus appropriated the banks receive a certificate, which cannot be sold, assigned or hypothecated, over which none of the usual rights of property can be exercised. The banks are obliged to make this subscription, or be

dissolved Charters have ever been regarded in the nature of a contract, and it is doubtful if, under our constitution, Congress can take away the charter of a bank in this summary manner, not because the terms of the charter have been violated by the banks, but because the bank management might refuse to make a coerced investment such as the pending measure provides

There is no provision whereby a bank which subscribes money to the capital of the Federal reserve bank can recover the same, except by liquidation, either voluntary or enforced A bank is given a maximum return of 5 per cent upon capital subscribed—if earned If the Government can appropriate one-tenth of a bank's capital in the manner provided by this bill, they may appropriate one-tenth next year, and so on until the capital is all transferred to the Government bank If they can fix the compensation at 5 per cent this year, they may make it 4 per cent next year, and 3 per cent, 2 per cent, 1 per cent or nothing—a very simple and easy process whereby the entire capital of the banks may be transferred to the Government

There are a great many different kinds of *socialism*, but, however the various theories differentiate, they all agree upon the fundamental proposition that the Government, that is the community as a whole, should own all the real estate, all manufacturing enterprises, all banks, all transportation companies—in short, all money-making utilities This proposition of the Government to take the bank's capital in the manner provided, carried to the extreme, would easily accomplish, so far as the National banks are concerned, this contention on the part of the socialists For those who do not believe in socialism it is very hard to accept and ratify this proposed action on the part of the Government

There are other provisions of the bill equally important and far reaching in their effect

We have recounted the condition which confronts us as to that provision of the pending measure, in order to impress upon the banks the fact that *we have reached a point where we must act in our own interests and for our own protection* Individually we must reach our conclusions in the premises, and if we are not satisfied with the provisions of the bill we ought to acquaint our respective representatives in Congress of the fact, and clearly point out and impress upon them the changes which we think ought to be made

It has been proclaimed in Congress and in the public prints that many features of the pending measure are exactly like or similar to provisions of the bill reported by the National Monetary Commission,

and which the bankers in convention approved. The question is asked, "Why, if the bankers approved such provisions in the so-called Aldrich bill, do they oppose similar provisions in the so-called Glass-Owen bill?" This is the reason:

(a) Investment in the stock of the Central Reserve Association created by the bill of the National Monetary Commission was permissive, not compulsory, banks might invest in the same if they chose, or they might decline the opportunity, in accordance with the dictates of their business judgment.

(b) Under the terms of the bill of the National Monetary Commission, the bankers controlled the management of the Central Reserve Association. It follows that an investment in the stock of the Association was an investment under their own control and management. On the contrary, investment in the stock of the Federal Reserve Banks of the Glass-Owen bill is *compulsory*. The individual banks have a minority representation in the management of these Federal Reserve Banks and have no voice whatever in the selection of the Federal Reserve Board, which dominates the Federal Reserve Banks, and the proposed measure only provides that one of the seven members must have banking experience.

The fact that the bankers controlled the Central Reserve Association was a guarantee against political control, and it was equally a guarantee against incompetent management—two important respects wherein the pending measure is lacking.

Protest to Congress

The outgrowth of this American Bankers Association meeting was a detailed protest to Congress and the President, coupled with proposed amendments designed to eliminate the features of the law that were chiefly objectionable to the bankers. According to the Bankers Association, the points that were most obnoxious included the provision for the transfer of reserve balances to federal reserve banks, the compulsory subscription to capital stock, and the close supervision and examination to be exercised by the reserve institutions. The country banks, on the other hand, were chiefly concerned with regard to the proposal to collect checks at par and thus to eliminate exchange charges, as well as with various phases of the

law which, they believed, might reduce their independence of action or might tend to cut their profits

But few of these efforts to bring about changes in the law were worthy of more than passing attention, save in so far as they merely voiced the general dissatisfaction with the proposal. Indeed, the bankers themselves indicated so limited a knowledge of the general principles of central banking that it soon became evident that there was but small service to be gained from a study of their proposals. As on former occasions, it soon clearly appeared that a very few outstanding figures in the banking community were practically able to control opinion, and that they represented influential elements who were primarily to be reckoned with. The great rank and file of the small banks of the country had neither thought sufficiently clearly about the pending legislation to protect themselves from absurdity in their statements concerning it, nor were they sufficiently agreed on the points which they supported or opposed to offer effective antagonism. This situation, in fact, was clearly revealed at the meetings of country and city bankers to which reference has been made. While it was true that the interests of the country and city banks were, as already explained, somewhat divergent, there was a sufficient degree of harmony between them to bring about "complementary" adoption of resolutions by country banks favoring the retention of the city reserve agent deposit system in such drafts as were adopted at the meetings of country bankers. On the other hand, reserve city banks usually showed their appreciation of the country institutions by taking issue with the exchange provisions of the Federal Reserve Act. It remained true that what the city banks were chiefly concerned to prevent was the elimination of the reserve agent deposit system, while the country banks were chiefly concerned to prevent the introduction of any general system of clearance which would diminish or restrain the power to make such charges as they saw fit.

Reserve City Bankers' View

Bankers in the central reserve cities and reserve cities had from the very inception of the measure been bitterly opposed to it because of the fact that it would take away from them, as they supposed, their country bank deposits. They saw in it, therefore, a threat directed against the profits of their business and they were keenly desirous that if the measure were to pass there should be eliminated from it the requirements that the reserves carried in the banks of the central reserve and reserve cities should be shifted to the new banks, their transfer to reserve banks to be made entirely optional. On the other hand, country banks found themselves sharply antagonized by the provision in Section 13 which called for the collection of checks without exchange. It was estimated at the time that fully one-third of the earnings of many country banks consisted of charges for exchange—charges, that is to say, that were made for furnishing remittances upon neighboring or distant cities and for remitting the proceeds of checks drawn upon the bank itself which were forwarded for collection. While it was not probable that banks of any considerable size were so dependent upon exchange charges, it was probably true that in all of the smaller banks the item of exchange was one of considerable significance. It was of course also true that the proposal contained in the reserve bill for a lessening of required reserves would have released so large a volume of funds that the banks would have found it profitable in any event to accept this in lieu of their exchange charges. That, however, involved a considerable readjustment of business, whereas the retention of the old system as to exchange charges was simple because it already existed, and because the machinery for applying it had been fully developed. Opposition therefore was strong on the part of country banks and grew more pronounced as the terms of the measure which the House of Representatives had passed became better known.

Bringing Issue Before Congress

The banks, however, were by no means content to leave this matter to be disposed of as the result of floor debate or even as the result of conclusions that might be reached by members of Congress upon the basis of resolutions adopted at bankers' conventions. They were determined to bring the matter definitely to the attention of Congress and of the administration and to make clear their opposition. In such efforts it was, as usual, true that differences of opinion existed with respect to the most feasible modes of approach. Reserve city bankers came to the conclusion that on the whole it would be wisest for them to appear directly before the Senate Committee and to see what could be done toward converting it to their way of thinking. Country bankers in the main preferred to stir up such opposition among the members of the Banking and Currency Committee as they could, eventually relying, however, upon their senators to secure presentation of their case on the floor of the Senate. Not a few of them sought to interest members of the Cabinet in their case and attempted by that means to obtain more attention than they could otherwise expect. On the whole, however, it had been believed that the best line of defense was very likely to be found in the Senate Banking Committee. The bankers of course had never intended to stop merely with their effort to convert the chairman of the Banking and Currency Committee of the House, although they believed that a thorough campaign against the provisions of the Federal Reserve Act obnoxious to them should start with that as a beginning. During the autumn and early winter while the Federal Reserve Act was under consideration in the Senate they accordingly endeavored to the utmost to secure favorable consideration in the upper chamber. This, however, was only after every endeavor with Chairman Glass and the administration to secure a revision of the proposed measure had failed.

Doubt as to Program of Opposition

The actual nature of the step to be taken in carrying out the program of opposition on the part of the bankers was uncertain. As just explained, there had been no definite or general agreement as to what was to be done up to the time when the new bill became public.⁶ So prompt was the subsequent work in the House that little could be accomplished there. The visit of the bankers' committee of protest to Washington came practically at the moment when the Banking and Currency Committee of the Senate was on the point of perfecting its organization. Various senators had unofficially let it be known that there was every intention of defeating the measure, and that if possible the President's wishes regarding it would be ignored. Many interviews to this effect, some authorized, others unauthorized, appeared in the press, and undoubtedly had the effect of leading many bankers to believe that there was no prospect of any immediate action on the bill even in committee. The belief that committee action would be postponed was further strengthened by an insistent demand for hearings which was put forward by some of the members of the Committee and which appeared to threaten indefinite postponement. It seems certain that on all accounts there was a very strong belief among the bankers of the country from about June 15 until towards August 1 or later that they might comfortably disregard what they had regarded as the danger that the new bill would find its way towards the statute books.

⁶The question whether the bankers would accept the Federal Reserve Act as it stood or in a modified form, or would seek to obtain its entire rejection had in fact become urgent from the moment of its adoption in the House. It had not been expected that any such prompt action would be taken by the House of Representatives, and the fact that it had been, coupled with the information which came from the Senate concerning the probabilities in that body, seemed to make it an urgent necessity that those who felt a real interest in the legislation should exert themselves. There was undoubtedly a decided division of opinion among the bankers as to the proper course to follow. Not a few of them entertained the opinion that the measure contained many elements of good, and that if it were not to be defeated it would be a long time before as acceptable a plan could be worked out. This view was probably not entertained by any active group among the banking community but was merely the passive impression of intelligent members of the profession who were not fundamentally affected by the legislation in one way or the other.

Lines of Attack

Even prior to the beginning of work in the Senate Committee there were not a few bankers in different parts of the country, who were accustomed to regard themselves as leaders of thought, to whom it appeared that they would act wisely by setting on foot an agitation designed to discredit the proposed measure in the minds of conservative and careful observers. Three main lines of action in this regard were undertaken, either as a result of similarity of thought on the part of bankers, or as a result of informal agreement among themselves. The first and most obvious plan of attack was that of seeking to discredit the bill as drafted on account of its "amateurishness." This purpose was carried out by the issuance of letters, statements, and the like, and through the medium of inspired newspaper articles. In all these it was sought to show that no adequate study had been given to the subject and that the proposed bill was careless in its wording and methods of expression. As little or no attention was paid to this form of attack by the government authorities or by members of Congress, attempts were speedily begun to convince members of the Committee that the language used was unsafe. Many bankers in each Congressman's district were induced to write personal letters to him, the outline or text of the letter being usually supplied by some city bank of which the banker communicating with the Congressman was a correspondent. At first the charges made in such letters were vague and included indefinite slurs upon the capacity of those (no names being mentioned) who had prepared the text of the measure. As such letters became numerous, and as a better esprit de corps was established among members of the Committee, it was agreed by the latter in each such case to write and ask for more definite specifications. Such letters were frequently unanswered but a certain number of responses came in. In these the attempt was usually made to pick out phrases and expressions that were said to be indefinite or meaningless. In very

many cases it was found that the phrases to which exception was thus taken were those which had been taken verbatim from the Aldrich bill and in a large number of instances it was possible to call the attention of the critic to the fact that he had indorsed the Aldrich bill—in some cases even that he had been personally responsible for support of the provisions to which he was now taking exception. Seldom, indeed, was a letter of this kind responded to by the banker who had at first begun the attack and the charge of amateurishness, except in its original and vague form, was speedily dropped.

Charges Against Honesty of Bill

The second method of criticism consisted of charges directed against the intent or effect of the bill in general terms. It was sought to show at first that the influence of the measure would be to produce a very great contraction of the currency and hence a severe panic. In singular contradiction to this effort was the attempt to make out a case for an inflationary tendency on the part of the bill. Among those who advocated the contraction idea was J. B. Forgan of Chicago, while George M. Reynolds of the same city urged its inflationary tendencies. The inflation charge was re-echoed by many of the New York bankers, who also added the prediction that the bill would inevitably drive gold abroad in large quantities. Correspondent banks of the "country" class almost invariably attached themselves to the contraction school of thought, asserting that they would find it next to impossible to make loans under the proposed provisions regarding reserves. The doleful predictions and hopelessly pessimistic forecasts thus put forward at first had a great effect upon the minds of Committee members. But here again the bankers injured their own case. As soon as it became evident that there was contradiction between the inflation and contraction schools of thought, members of Congress not unnaturally refused to be frightened inasmuch as the argument on one side was as good

as it was on the other, so far as the weight of authority was concerned

Threat to Leave National System

The third method of attack resorted to consisted in the bald assertion that if the bill should be passed banks would surrender their national charters. This was simply a threat. There was nothing to indicate that such a surrender would be profitable or even possible for the banks—certainly nothing to suggest that they could easily carry through the undertaking should any considerable number of them decide upon it. Actually to surrender their charters would have involved an enormous amount of inconvenience, but in addition, it would also have implied the necessity of turning in to the government a quantity of lawful money equal to the amount then outstanding in order to provide for the retirement of the bank notes, while it would also have implied the sale of the bonds which had been placed by the banks with the Treasury Department for the purpose of protecting their issues. Had so great a quantity of lawful money been withdrawn from circulation, it would have implied the turning over of a considerable part of the fluid assets of the banks to the government, while the sale of the national bonds would have unquestionably resulted in a very great depreciation in the market value of those securities. All this was well recognized by members of Congress as the fact in the case and the inspiration of the campaign against the proposed bill began to be revealed. Consequently, after the first week or two during which it was used, the threat to surrender national charters had very little influence either in the Banking and Currency Committee or on the floor of the House itself.

Work of Bond Dealers

Another effort to influence the situation was, however, set on foot in New York. Failure to get any hold upon members

of Congress and of the administration had been due to the fact that most of the early efforts against the bill had been engineered by these larger institutions and had been shared in only to a limited extent by the small banks. It was therefore sought to apply some pressure upon the small institutions which would induce them to take up arms vigorously in opposition to the bill and by bringing pressure to bear upon the members whom they could reach to insure its defeat. The plan finally determined on was that of arousing alarm about the price of United States bonds. As was well known, the United States 2 per cents had long been in an unstable condition, owing to the changes in the value of money and in the rate of interest. The banks had in years past already written off premiums on these bonds aggregating some \$30,000,000 at the request of the Comptroller of the Currency and were not desirous of incurring further losses on that score. They were carrying the bonds on their books at par value, and it was the effort of leading bankers to mask any further tendencies towards a decline. Nevertheless sales of 2 per cent bonds were privately made during the early months of 1913 at 98 and less. It was now argued that the weakness of these United States 2 per cent bonds indicated a serious danger to the government credit and particularly as showing that the banks which owned bonds could not get rid of them except at a very heavy loss. Sales of bonds on the New York Stock Exchange began to be made at low prices and it was given out in a good many quarters that the low valuations were due to fear on the part of the banks regarding the effect of the new bill. Investigation showed that this alleged fear was in no way responsible for the reduction in price, but that a considerable number of bonds had been sold short and that in other ways the price had been artificially reduced. In fact, when a broker acting in the interests of the Treasury attempted to obtain 2 per cent bonds at the quoted prices, offering to pay the value thus established, he found himself unable to get the securities and, as just stated, an

investigation established the fact of the short sale. It is probable that the wide publicity given by New York interests to the fact that prices were tending downwards in the bond market did have a considerable influence upon the minds of bankers in the interior, but the Treasury immediately announced its intention to seek a modification of the bill that would amply protect the bonds in every reasonable particular, and the consequence was an almost immediate subsidence of the anxieties that had been expressed by bankers who feared that they might not be able to put their bonds on the market at fair prices should the existing conditions continue.

Activity of Business Organizations

Brief reference has already been made to the attempt to discredit the Federal Reserve Act during this preliminary period made by various so-called "business organizations" designed to carry out the bankers' wishes.⁷ Among these the National Citizens' League and the United States Chamber of Commerce were prominent. From the time that the outlines of the Glass bill had become known, the National Citizens' League had been active in its opposition to its outstanding features. The organization had sought to secure in the first place the elimination of the new reserve provisions. John V. Farwell, the president of the League, in the early spring had written a letter already quoted in which he said on this subject:

As to changing the reserve laws, as to reserve cities and central reserve cities—it seems to me that this important change should not be made at this time.

Let them take one step at a time, as has been intimated they are going to do. Is not that much the safest course?

So also had the League sharply antagonized the plan for the par collection of checks, and the bestowal of clearing house functions upon the reserve banks. On this point Mr. Farwell wrote

⁷ *Supra*, p. 10.

In regard to obliging country or other banks to give their depositors exchange free, within the district in which the bank is located, I believe this would be very unwise

Earlier the League had advocated the use of domestic acceptances, the inclusion of bank notes in reserves of member banks, and other objectionable features which had played a part in the Aldrich bill. In order to attack the provisions of the Glass bill, differing widely as the latter did from those of the Aldrich measure, the League found itself obliged to reverse its former position on both these points, which it promptly did, although without repudiating its earlier advocacy. Members of the League occupying influential and official positions in its ranks, however, continued to advocate the inclusion of the domestic acceptance plan as well as the granting of power to count bank notes as reserves. The headquarters of the League had determined to advocate the sole use of gold as reserves, in order to combat the provision of the Glass bill which required only lawful money reserves, and to that end it found itself obliged to surrender the bank note proposition of its earlier days. Moreover, the League actively attacked various administrative phases of the bill as well as the number of banks provided for in it.

The reserve provisions as well as those relating to par clearance were likewise attacked by other organizations which did all they could to defeat them—besides criticizing nearly all of the salient features of the measure from the administrative standpoint.⁸

Criticism of Financial Attitude

The only conclusion which can reasonably be drawn from a careful survey of the attitude of the banking public during the late summer and early autumn of 1913 must be that the earlier professions of desire to see a scientific banking system established had been forced into the background while the

⁸ The letter appearing as Appendix A at the end of this chapter illustrates this attitude.

special interests of various groups of bankers and financiers had come into the foreground. The attack was now entirely designed to assure retention of the old reserve deposit plan whereby bank reserves were kept in specified cities, the retention of the old collection system whereby city banks acted as collecting agents to country banks, the avoidance of any more extensive government interference with banking, through the reconstruction of provisions in the measure relating to the operations of the Federal Reserve Board, the boards of directors of the federal reserve banks, and to the examination system, while the question of government bonds held by the banks and the treatment to be accorded to them which had always been foremost in the discussion continued to maintain its prominent position with but little alteration save that the anxiety to secure protection for the existing values of the bonds was more intense. Perhaps there had never been a great movement which had so completely and emphatically "slumped" from its early professions as that of banking reform or which had so unreservedly gone back to a position of anti-reform. "We thought we wanted banking reform," said a member of one of the organizations prominent in Washington, "but we have concluded that we are getting a little more reform than we had reckoned upon." The view thus frankly expressed was unquestionably widely entertained, and the fact that it was so rendered the task of those who were to attempt the adoption of the new bill in the Senate a doubly severe one.

Some Palliating Circumstances

All this need in no sense be taken as a criticism upon the bankers or financial community. Like other elements in American citizenship they had their own private and professional ends to serve and these they sought to promote by all legitimate methods. The banking struggle had in fact taken on a complexion quite similar to the ordinary tariff contro-

versy In thus recognizing the real policy pursued by the bankers with respect to the new bill, there is therefore no suggestion of illegitimate or unusual opposition to public interests There is, however, the obvious indication that the bankers no more than other sections of the community were inclined to follow the public interests and that they did their utmost to defeat or emasculate a measure which was subsequently considered to be conspicuously sound and beneficial Their opposition, moreover, was directed at the characteristic elements in the measure and had it been successful would entirely have deprived the bill of any effectiveness or merit This is an important fact of financial history, deserving to be carefully borne in mind It effectually unmasked a hypocrisy, which had for long years maintained that the bankers of the country were seeking only the well-being of the business world or of the nation, a view which had been very currently and very widely adhered to throughout the country It was, moreover, of utmost importance when the Federal Reserve Act came to be put into effect, because at that time the new banks found themselves obliged to meet throughout their early history the more or less consistent opposition of the banking interests which had striven at the outset to secure the modification or defeat of the measure

The Federal Reserve Act was perhaps the first measure of broad international significance which was completed and eventually brought to a passage with the direct, consistent, and steady opposition of the banking interests which were most materially affected by it, and which nevertheless within a comparatively short time proved its utility not merely to those interests but to the nation as a whole Indeed, the combined bankers of the country maintained a spokesman at Washington whose efforts were continuously directed, among other features, against the reserve provision, and who up to the very latest moment of the Conference Committee between the Senate and House, which adjourned long after midnight on

December 22, was still standing in the corridors of the Capitol urging upon those whom he had opportunity to converse with the necessity of omitting the provision requiring transfers of reserves to reserve banks, the principal and vital change introduced by the new measure⁹

APPENDIX A TO CHAPTER XVII

LETTER ON FEDERAL RESERVE BILL WRITTEN TO CHAIRMAN GLASS BY
THE PRESIDENT OF THE UNITED STATES CHAMBER OF COMMERCE

Chamber of Commerce
of the
United States of America
Riggs Building
Washington, D. C.
President's Office
10 South La Salle Street
Chicago

August 8, 1913

Hon Carter Glass,
Chairman, Banking & Currency Committee,
House of Representatives,
Washington, D. C

Dear Sir

I am taking the liberty to write this letter to you alone rather than to duplicate it to Senator Owen and to Mr McAdoo I feel I should rather have your interest in the presentation of any suggestions which may appeal to you as the result of this letter than to have the divided interest of the other gentlemen of the administration responsible for the success of this measure

I think in view of the caucus that will be held on Monday on the Currency bill you will be interested in a few field notes the result of a trip covering eleven states made by the Directors of the Chamber of Commerce of the United States, from July 5th to July 27th Every

⁹ And yet one of the representatives of the bankers' views in this matter of reserves had written a letter as early as June, 1913, emphasizing the mobilization of reserves as "the fundamental basis of any sound plan" The letter is reproduced as Appendix B to this chapter

opportunity was afforded to us to meet the business men and bankers, not alone of the cities in which we stopped, but through the fact that delegations boarded our train and travelled with us through several of the states, we came into contact with the viewpoint of the business interests in the smaller towns rather than being confined to the principal cities. Up to the time that the report of our Committee was received by wire in Los Angeles, we could only discuss the administration measure in a general way. Following the receipt of that report, we were able to meet with clearing house committees, and in one case with the Executive Committee of a State Bankers Association, and also to get the viewpoint of business men who were not in any way related to the banking profession.

The consensus of opinion covering the entire territory over which we travelled, from the Missouri River west, indicates a strong desire on the part of the business interests of the country for the passage of a currency measure. There is a deeper interest on the part of the business men than I have seen them heretofore exhibit in regard to any piece of national legislation. Among the bankers, there is a strong desire for larger expert representation on the Federal Reserve Board. In the main, however, the suggestions made by the Chamber of Commerce Committee proved entirely satisfactory, and, except in Los Angeles, the bankers conferred with were inclined to believe that such a Board and Advisory Committee could most acceptably direct financial operations under the bill.

There are two vital points of tremendous interest to the territory over which I have travelled and I shall briefly refer to these in the light of information received from Professor Scott yesterday covering the latest developments as he ascertained them when with the National Citizens' League Committee in Washington on Monday.

Suppose we take it for granted that this legislation will be difficult to pass without the co-operation of the country banker. It is concerning him that I have the greatest amount of fear. He is insistent that the bill should provide an option to deposit some per cent of his reserves in reserve city banks and even if the proposal made by Mr. Farwell and his committee, to reduce the reserve from fifteen to twelve per cent, should ultimately become the law, this to my mind will not satisfy the country banker as well as to keep his reserve at fifteen per cent and receive the option to carry perhaps a third of his reserve money with reserve city depositories, and if the reduction of the reserve to twelve per cent was accompanied by the permission to carry some fraction of this reserve as heretofore outlined, it would be a

strong bait to the country banks to draw their co-operation I understand from Professor Scott that it has practically been determined to adhere to the original provision requiring after three years that reserves be carried either as cash in vault or on deposit with Reserve Association I urge your reconsideration of this matter, not because of my own personal preference, but because of the actual experience which I have had through a number of states and talking with a very large number of men deeply interested in this question

The other proposition to which I especially invite your attention is the contribution of the country banks to the stock of the Reserve Association in order to become member banks As a common sense proposition, have not the country banks the right to demand their contribution to the stock of the Reserve Association shall be, in some measure at least, proportionate to the value which they expect to get out of the Reserve Association? Everywhere along the line there is a distinct difference conceded as between requirements for country banks and for reserve city banks, except only in the proportion of the capital stock which must be subscribed to the capital of the Reserve Association Is it not quite as logical, in view of the clear line that has been drawn between reserve city banks and the country banks, to provide in your bill that the contribution to the capital stock of the Reserve Association by the country banks shall be ten per cent of the capital stock of the bank, five per cent in cash and five per cent in a demand obligation, whereas the reserve city banks be held up to the present provisions of the bill?

It seems to me that here again is an opportunity to show favor to the country banks and justly, to give them the right to become members of the Reserve Association upon a contribution to the capital stock which will more nearly represent the proportionate good which they will get out of the institution

Now, Professor Scott tells me that it is favorably considered that the method of distributing the profits of the Reserve Association be changed so that first, a surplus of twenty per cent is created and thereafter, the earnings are divided, sixty per cent to the government and forty per cent to the member banks Suppose that this provision could be enacted into law by concurrence of House and Senate, and I am not ready to admit under present conditions that this would be possible, I believe the country banks would prefer to have the right to contribute their smaller proportion to the capital stock of Reserve Association than to take their chances upon increased earnings making

their larger investment as profitable as the basis upon which they could otherwise dispose of their available funds

Upon two other points, the banks of the Coast states and the Northwest desire to be assured, but these points, as I understand, can be made quite clear without any amendment beyond that now proposed. One has to do with the retirement of national bank notes at the rate of five per cent per annum for twenty years. The banks desire to understand that nothing can compel them to retire five per cent per annum, permitting those banks which desire to retain their circulation as long as it is profitable and that where in any year the full five per cent is not offered for retirement those banks desiring to retire more than five per cent may apply to the federal reserve board for that right and be given the privilege until the full limit of five per cent has been exhausted. Their other point has to do with an interpretation of the term "commercial paper." Oregon ships large amounts of natural and manufactured commodities to the Atlantic seaboard on time drafts, thirty to forty-five days. These drafts with bills of lading attached are used at the local banks and the banks desire to be assured that this class of paper would be interpreted as commercial paper subject to rediscount with the Reserve Association should it become necessary for them to reimburse themselves by reason of extraordinary demand in their own locality. I have tried wherever we have met with business men and bankers to urge them not to demand too close an interpretation of such terms as "commercial paper", that authority given to the federal reserve board should be permissive, not mandatory, that the effort to clearly interpret what might be termed commercial paper would mean in fact a restriction in the operation of the bill and that the general term so long as it could be understood to cover all paper having to do with the movement of goods and commodities would naturally be construed under the term "commercial paper."

I hope you will not be worn out with this letter. I have felt that as quickly as possible you should get the viewpoint of the states through which we travelled, a viewpoint gathered after seeking an entirely impartial attitude of those persons conferred with, and I sincerely hope in the caucus which will be held next week it may be decided to give further consideration to the rights of the country banks and the proportionate good which they would get out of the operation of the Reserve Association and accord them in an amendment the right of option to deposit some part of their reserves with reserve city banks and especially that their contributions to the capital

stock of Reserve Association need not be so large a proportion of their capital as may be required from reserve city banks

Very sincerely yours,
(Signed) HARRY A WHEELER
President

APPENDIX B TO CHAPTER XVII

LETTER TO SECRETARY MCADOO URGING NECESSITY OF PROTECTING COUNTRY'S GOLD RESERVES

The New Willard,
Pennsylvania Avenue, Fourteenth & F Streets

Washington, D C, June 26, 1913

The Honorable

The Secretary of the Treasury,
Washington, D C

Sir —

No stenographer was available when I reached the Hotel last evening, which will explain why the delay has occurred in sending you the enclosed

It is difficult to estimate the relative importance of one feature where all are so intimately interwoven In summarizing my views, I would say

1 No plan can be sound or successful without satisfactory disposition of the bond secured currency and necessarily of the bonds upon which it is based

2 Mobilization of reserves is the fundamental basis of any sound plan The number of regional banks must not be so great as to nullify this purpose

3 The primary purpose of note issues is protection of the reserves, the mobilization of which is all important Notes must be of a kind which will flow out instead of lawful money and disappear by redemption as rapidly as the need for them ceases

Notes issued upon the plan which we have suggested will attain this end (viz, protection of reserves and automatic adjustment of volume to business needs) far more effectually than in the plan proposed in the bill

The above are the main economic considerations in our suggestions The matter of reserve is, I take it, rather an actuarial problem Your desire, and ours is, of course, to have the reserve so determined as to have it advantageous and not disadvantageous to banks to enter the

system and so that the least disturbance will result commercially and industrially

Touching the matter of control, only the result of trial can determine whether the administration's view is right, that the Federal Board should be entirely independent of the banks or whether our conviction is right that the banking interests should have representation on that Board. If the right is given to the Federal Reserve banks to control their own discount rate, subject to review or intervention by the Federal Board, that, it seems to me, might be an acceptable compromise.

Export Tax on Gold It would seem desirable to incorporate a provision giving the Federal Board authority to impose an export duty on gold in the manner suggested in the enclosed paper.

With appreciation of the sincerity of your desire for wise banking legislation and of your patience and courtesy in hearing us, I remain,

Yours respectfully,

(Signed) JOHN PERRIN

PERRIN, DRAKE & RILEY,
210 West 7th St.,
Los Angeles, Calif

(Enclosed Paper)

EXPORT DUTY ON GOLD

After careful consideration of the thirty questions propounded by Senator Owen, I find that an essential feature has been entirely ignored without which no general banking scheme could be a success. No suggestion or intimation is made with reference to the protection of our gold supply.

It would be fundamentally wrong to place undue restrictions upon the flow of gold when used in the settlement of international balances but it is perfectly proper to have a brake system to be applied in order to prevent the wheels from going too fast and to place a proportionate burden on specific commodities rather than upon the entire fabric.

The methods in vogue abroad are about as follows.

Bank of England The redemption of Bank of England notes against Sovereigns is absolutely inoperative notwithstanding the claims of the British Bankers to the contrary. A mere hint from the Bank's officials that it is not convenient is sufficient to forestall any demands in this respect. Smallish amounts of Sovereigns have been picked up in the past through bullion dealers, but these were unfit for circula-

tion and would have been turned into the mint for melting purposes anyway

The Bank of England, however, in normal times parts with its holdings of foreign gold but at a price commensurate with the demand

In explanation, I may say that the Bank aims at all times to have a supply of the principal foreign coins in its vaults, booked at actual gold value on the basis of 77/9 per standard ounce. These coins are placed in bags 500 ounces each and, in order to make the weight exact the coins are clipped. As the demand increases, the price is raised up to a point when the Bank refuses to sell at any price, and the only source of supply left is the open market which, as a rule, is absolutely bare unless for moderate use in the Arts and Industries. There then remain the weekly arrivals from South Africa, which are for private account and are offered in the open market. The Bank of England, however, by courtesy of the Trade, has the right to take over any portion of this gold at the highest bid made for same. This is the much vaunted free market for gold in England.

Bank of France Has the right to redeem its notes either in gold or silver in 5 Franc pieces, and, when notes are presented for redemption, naturally elects payment in silver. At times the Bank will sell gold either in the form of Napoleons or in bars, and the price is in the form of a premium ranging from one per mille to two per cent. The calculation for gold in France is on the basis of F 3427 per Kilo fine. When the Bank of France desires to replenish its supply, it does not hesitate to do so even in the face of adverse exchanges and generally selects the United States as its victim, as no opposition is ever manifested towards this course.

German Reichsbank Gold is absolutely unobtainable in Germany for export at any price. Their basis of calculation is M 2784 per Kilo fine. For comparative purposes, France and Germany can be left entirely out of consideration, hence, we have England only to deal with. With adverse exchanges, predicting an outflow of gold, the first step is to put up the prices and the next is raise the bank rate. This is the last resort and, while it is done with considerable reluctance, still they never hesitate to apply it and it generally has a remedial effect. The United States is the only absolutely free market for gold in the world, and we have to suffer for our liberality. When South American exchanges are against Europe, the burden is thrown upon us, and this also applies to the exchange relations of France and England, and we have no remedy to apply to speak of. A nominal charge is made for bars when these are desired for export (40 cents per \$1,000). This charge was arranged years ago and was supposed to cover the cost of

making the bars, but I understand the actual cost is greatly in excess of that. Now, gold bars and particularly American gold bars are greatly desired abroad on account of the reliable work put into their manufacture, and besides, there is a slight advantage to the exporter on account of our method of assaying—the American method is to assay in quarters while the European method is in tenths.

Now, if conditions are normal and exchanges are against us, it would not be wise or good business policy to place any restrictions upon the export of gold at all, but if we can see that an export would still further aggravate a strained condition, it would be perfectly proper to apply the brakes, particularly so as recent legislation has made it easier to obtain bars than formerly. How to do this is the question. We could add a premium to the cost of the bars, but this premium could not be placed higher than $\frac{1}{2}$ of 1 per cent as that is about the difference between bars and coined gold. In explanation of this discrepancy, let me say that with coined money there is a legal tolerance of $\frac{1}{2}$ of 1 per cent, but the work at the mint is very accurate and the actual deficiency in new coin is far below that figure, but the Treasury in putting up its gold does not distinguish between old and new coins, hence, we have to strike an average to bring into account abrasion caused by circulation—this average would be about $\frac{1}{4}$ per cent and my authority for this figure is the record of the Treasury Department, which shows that the average weight of every \$5,000 bag is 5,365 dwts while the authorized minimum is 5,347 $\frac{7}{8}$ dwts while the maximum is 5,375 dwts. This premium could be made on a sliding scale with a maximum of $\frac{1}{4}$ per cent. This is about the limit of arbitrary action. Of course, all of this is predicated upon a legitimate export demand on the basis of exchange rates. However, if the demand is an illegitimate one, such as recently took place in connection with gold shipments to Paris, which was nothing less than an act of piracy, the President of the United States should be empowered to proclaim an export duty of 10 per cent on all gold exports unless it can be shown that the export is taking place strictly on the basis of prevailing exchange rates.

This is rather a lengthy preamble, but is necessary to bear out the following arguments in connection with the proposed Reserve Association. Should the Association be created, a foreign portfolio would be absolutely necessary. This principle has only recently been recognized by the Bank of France and adopted. This portfolio need not be very large, probably ten or fifteen million dollars, and should consist

of the very finest paper procurable and each item should bear the earmarks of a legitimate trade transaction

This would, on its face, appear that the Association would have to go into the foreign exchange business in competition with its member banks, which, however, is not necessarily the case, as this portfolio could be obtained through the intermediary of its member banks and could be replenished through the same source. Inasmuch as the portfolio would have to be the pick of names, both as to drawers and drawees, the member banks would, in addition thereto, endorse them and would charge a premium for so doing, probably $\frac{1}{8}$ of 1 per cent. Thus, in handing over to the Central Association its best paper, the member banks would be obtaining a greater profit than if they used them in their exchange operations. At times, of course, there is no such paper to be obtained in this market, particularly during the first six months of the year, but that would not be a deterrent, inasmuch as, through a personal representative located say in London, prime English names could be taken up in that market under ruling discount rates and held for the purpose of the Association.

Under prime paper, it is to be understood that only the paper accepted by native banks should be considered. For instance, on England only English bank acceptances, such as would be taken by the Bank of England. For example, a draft drawn on a foreign bank having an Agency in London would not be taken at all, nor would a draft drawn on the Continent payable in London be taken, and the same rule would apply to French banking paper as well as German. However, for the present a portfolio of prime English bank paper would be sufficient for this purpose. This portfolio could be made the basis of the note issue along with American commercial paper to a certain percentage, similar to that prevailing with the Deutsche Reichsbank. The returns on such a portfolio would not be very great but its principal advantage would be to enable the Association to draw gold from Europe in case of necessity, or to counteract an undue demand for gold from this country. Even as an investment, it would pay and the bulk of it could be acquired at the time of the year when most of our commodities are sent abroad, that is in the fall when the principal movement of cotton and cereals takes place. The exchange would then be cheap and, in addition to the interest they would bear, there would be a profit in the exchange. These bills maturing in practically three months would have to be removed possibly, and when the movement is in the opposite direction, say in May or June, with exchange high, the holdings could be thrown upon the London market in satisfaction

of European claims for imports, thus reducing the demand to just that extent and thereby obtaining a fair profit. In the intervening months, where exchange is normal, there is a fair return in interest, and any loss in exchange which would occur would not be worth considering, taking into account the grand principle to be applied in protecting our gold holdings. Other than the mere business of taking care of this portfolio, it would not be necessary for the Association to engage in any other form of foreign banking.

CHAPTER XVIII

THE ECONOMISTS AND PUBLICISTS

\ Position of Publicists

Deeply interesting as was the attitude of the banking community of the United States on the whole subject of currency and banking legislation, the position assumed by the economists and publicists of the country was hardly less so. The Federal Reserve Act is frequently referred to as the combined outgrowth of scientific and professional effort—the bankers of the country affording the latter, the economists and publicists the former. There is a certain underlying truth about this assertion which ought to be fully recognized, but the general structure of opinion which is built thereon is wholly false. Just as the bankers of the country were unable to unite upon anything more than a limited measure which would provide emergency relief for themselves in case of stringency, and speedily proved their opposition when it was attempted to go further and to legislate in the general interests of the community, so the economic and scientific figures of the United States quite early showed that they too were unable to assume a general public-spirited attitude on the subject. The causes which led to the assumption of this significant opposition among the economists are very complex but are well worthy of careful analysis.

Nucleus of Opposition

A first nucleus of opposition to the new measure was naturally to be found among those who had supported and advocated the Aldrich bill. As has been seen at other points in this

volume, there was no necessary opposition between the ideas of the Aldrich bill in particular and the principles of a general nature which underlay the Federal Reserve Act. Both aimed at somewhat the same general object and used somewhat the same means for the attainment of that object. The Aldrich bill was vitiated by special interest concessions, by inadequacy, and by shortsightedness, but there was no reason why one who believed in the principles underlying the Aldrich measure should not have regarded the Federal Reserve Act as a further development and broadening of those same principles. Nevertheless it was true, from the active opening of the discussion of banking in 1912 to 1913, that all those who had supported and furthered the Aldrich bill and that many of those who had furthered the work of the National Monetary Commission intended to oppose the Federal Reserve Act. Logically speaking, it is not clear, as has just been shown, why any such situation should have existed. But without requiring adherence to the abstract notions of logic, it is also difficult to see why from the merely human standpoint any such opposition should have prevailed. The National Monetary Commission had been a bipartisan organization, composed of representatives of both the Republican and Democratic parties. Those who had worked on the scientific side of the National Monetary Commission report were in few or no cases deeply biased politically. The Banking and Currency Committee of the House of Representatives never repudiated the good points in the Aldrich measure, on the contrary, as elsewhere shown, it adopted them. It had offered some criticism of the Aldrich movement, in the report of the House Committee, but such criticism was certainly measured as compared with much that had preceded it. Nor had there been any effort either, in or out of the Federal Reserve Act, to attack or damage the banking interests; on the contrary, their legitimate position had been carefully safeguarded. The antagonism of the Aldrich group was, however, evident from the very beginning and came to a climax in the

address offered by Senator Aldrich himself before the American Academy of Political Science in New York in the autumn of 1913 At that time Mr Aldrich said

The theory that the United States should issue currency in the form of its promises to pay is a populist doctrine It had no standing as a Democratic party principle until the advent of Mr Bryan as the nominee for the presidency in 1896 It was injected by Mr Bryan into the party platform in spite of the protests and against the votes of the men who had been most prominent in the party councils, men who advocated loyalty to the policies and principles to which the party had adhered throughout its existence . If the House bill should be enacted into a law, Mr Bryan will have achieved the purpose for which he has been contending for a decade

The incorporation of the provisions for government note issues in the administration bill is certainly a great personal triumph for Mr Bryan, but it is, at the same time, an emphatic condemnation of the theories of government and the economic teachings of every great Democratic leader from Andrew Jackson and Thomas H Benton to Samuel J Tilden and Grover Cleveland

The features of the bill to which I have called attention are of such a character that they should not be accepted I have tried to show that the House bill has serious defects It appeals to the populists by adopting their plan of note issues, to the socialists by seeking to place the management of the most important private business of the country in the hands of the government, it seeks the support of bankers in great centers by its unexpected discrimination in their favor, but its dangerous doctrines and unwise methods do not appeal to the sound judgment of the American people

Views of A P. Andrew

A Piatt Andrew had been Assistant to the National Monetary Commission and later Assistant Secretary of the Treasury, working closely with former Senator Aldrich and presumably with the financial group with which the latter was affiliated His views undoubtedly may be taken as representing those of

Mr Aldrich, although not expressed as the latter would have put them They are of particular interest in view of the subsequent claim that the Federal Reserve Act had been borrowed or "plagiarized from" the Aldrich bill As soon as the Reserve Act had been made public, Mr Andrew issued from Gloucester, Massachusetts, on June 25, a lengthy article entitled "The Bryanized Banking Bill," in which he reviewed the measure from beginning to end After stating that the bill had been awaited with "open-mindedness and high hope by thoughtful people of all parties," and while noting that the President was "himself a distinguished scholar," while the Congressman (Mr Glass) who had introduced the bill was "a man of earnest and sincere intentions," Mr Andrew went on to say that the measure as framed was weak and dangerous, placing far too much power in the hands of the President, establishing an unworkable system of divided reserves, granting a political control over banking, very "repugnant to all of the traditional theories of the Democratic party," and unsatisfactorily framed Said Mr Andrew:

I believe that its note issue provisions are inflationary and without contractility, that the reserve regulations suggested for the national banks are ineffectively framed, that the reserve requirements proposed for the reserve banks are dangerously inflationary and inelastic, that the proposed reserve banks are too numerous to accomplish their desired objects, that the proposed endowment of the Federal Board with other than supervisory power is altogether unwise, and finally that the only result of the adoption of the bill would be the utter obliteration of the one great forward step made in banking legislation during the nineteenth century, namely the establishment of the National Banking System It is fortunate and significant that the bill is only regarded by the President as a tentative working basis

Just how fortunate and significant this was Mr Andrew was still to learn when it appeared that the President intended

to adhere with the utmost rigidity to the essential provisions of the Glass bill ¹

Apparently Mr Andrew did not consider the federal reserve measure "a plagiarism" or copy of the Aldrich measure, framed by the Commission to which he had acted as Assistant

Criticism of Paul M. Warburg

Another writer on banking and currency, himself a member of a well-known private banking house of New York and later to become a member of the Federal Reserve Board, Mr Paul M Warburg, was also among those publicists who took occasion to devote attention to the theory underlying the Federal Reserve Act and to discuss the proposals offered in it At another point it has been seen how Colonel E M House had selected Mr Warburg as the representative of the banking interests of New York to whom to submit the preliminary digest of the measure which he had obtained from President Wilson In that connection reference was made to Mr Warburg's first criticism upon the bill, which was then in its third stage of development No further reference to this earlier portion of the discussion need be made at this point After the bill had become public property copies of it were doubtless forwarded to Mr Warburg, who was then in Europe, where he continued during the summer and early autumn In two pamphlets which he sent back for distribution among bankers and technical students of the situation, Mr Warburg devoted during the summer very detailed attention to the provisions of the measure He there showed that the plan was practically impossible and that, far from remedying the evils from which the banking community complained, would aggravate them He took special exception to the number of reserve banks contemplated by the proposed law and objected also to the concentration of reserves which was required by it The effort to

¹As in other cases, this attack of Mr Andrew's has been later explained in controversy as directed against provisions subsequently eliminated by the Senate This view is fully discussed in Chapter XX.

develop a regional system of banking with a discount rate appropriate to each of the various parts of the country in which reserve banks were established was, thought Mr Warburg, wholly out of the question. The effect of it would be to prevent the evolution of a satisfactory American discount market and thus in a sense to defeat the entire object which was sought. In fact, there were few portions of the bill which Mr Warburg considered at all satisfactory and he strongly urged extensive modification of the measure along the lines already referred to.

This attitude was continued by Mr Warburg after his return to the United States. He was constantly communicating his views to Chairman Glass during the autumn while the measure was passing through the Senate Banking and Currency Committee and afterwards through the Senate itself, and having finally become convinced that the bill was to be passed, he sought to obtain either the flat reduction of the number of banks called for by its terms, or, at all events, the arrangement of these banks into some three or four groups in each of which there would be a central control or oversight over the other units in that section.² Had this plan succeeded, it would have in effect established some three or four banking centers for the country as a whole, although each of these centers, or nuclei, might have consisted of three or four banking units. The plan as proposed, although thus repeatedly put before Chairman Glass, met with no approval, but effort to demonstrate its availability continued almost to the close of the work of the Conference Committee of the two houses. A proposal of the same sort was made after the Federal Reserve Board was established a year or more later, but the nearest approach the plan ever made to success was seen in the administrative grouping of the banks which occurred during the year 1921 and was intended for convenience of interbank con-

² No "decent men" said Mr Warburg the day before adoption of the measure, would accept membership on the Federal Reserve Board as then provided for.

sultation and uniformity of practice Mr Warburg, in fact, as the Committee steadily declined to introduce this final modification, definitely expressed the opinion that the measure could never succeed.

Other Banking Criticism

Not a few of the bankers and business men of the country also "took to print" and either in newspaper and magazine articles, or in pamphlets which they issued and circulated at their own expense, plainly showed that the new measure was destined to be an utter failure. In the main they were joined by the general rank and file of economists of the country, who were almost unanimously of the opinion (so far as public expression of their views could be obtained) that the measure was unsound and must fail of success. Early in the work of the Banking and Currency Committee during January and February, 1913, it had been determined to ascertain the views of some representative economists if possible, and with that in mind a questionnaire had been sent to a select list of those who in the past had written upon banking and currency, or who were known to have made that subject a specialty. While there were many who did not answer the questions put to them, a sufficient number returned replies to afford a fairly good review of prevailing opinion among the economic community. This on the whole was unfavorable, the majority of those who responded favoring the establishment of a central bank and giving the familiar reasons for the belief that nothing short of such a bank could be expected to remedy the defects of the financial system as then organized. As time went on, and especially after the bill became public, not a few of the economists joined the bankers in open denunciation of the measure and in pointing out its defects. This would have been a useful service had it not been for the fact that the discussion assumed form almost wholly as a destructive attack upon the proposed measure and in few cases offered anything

in the way of constructive or fresh suggestion. The central bank idea had undoubtedly become very firmly implanted in the economic community, while it was also evident that to some extent political prejudice had helped to color the views of these critics.⁸

Views of Mr. Aldrich

The discussion of the bill on the part of the scientific community was perhaps more clearly focused at the meetings of the Academy of Political Science in New York during October, 1912, than at any other time. During these meetings many points of view on the subject of banking and currency in general and of the proposed Federal Reserve Act in particular were brought to the front. The general idea of the regional organization of the banking system was sharply condemned by several, while the same argument relative to the impossibility of establishing local discount markets at various points throughout the country was once more urged. It was at this meeting that Senator Nelson W. Aldrich presented the lengthy denunciation of the entire proposal which has been frequently referred to and in which he pointed out the total dissimilarity which existed, according to him, between the act that had popularly been designated as his and the Federal Reserve Act.

Hostility of the Press

Nor was the criticism of the Federal Reserve Act by any means confined to professional and expert writers on banking and finance. The press in general was significantly hostile to the bill from its very inception. It was true that during the months preceding June, 1913, the only accounts of the measure which had been allowed to get into print had been based upon hearsay and rumor, and that their authors could not have been

⁸ Some representative examples of the opinion thus drawn forth are reprinted in the Appendix to this chapter.

expected to verify them from any authentic source. In fact, the contents of the proposed law were so well protected that, except for the action of Colonel House already referred to, and perhaps that of one or two others in distributing outlines of the bill to outsiders, the general terms of what was planned had never been seen by anyone during the entire course of their preparation beyond the small circle of those who were immediately concerned in preparing the measure or in passing upon it. True, as has already been explained, Chairman Glass had not hesitated to state, or to authorize others to state, to any serious inquirers, the main purport of what his Committee was endeavoring to do. But this, of course, was far from being the same as the issuance of an authorized and authentic statement in writing or in print. So in fairness the criticism of the press must naturally be studied only from about the middle of June, 1913, onward, and must be considered to date from the moment when the bill in its first finished form was actually given to the public.

The mind of the press had, however, been thoroughly poisoned against the whole proposal. Its Democratic origin, the fact that the banking community was so generally opposed to it, the weighty testimony of many economists to the contrary, and in general the lack of any campaign of education designed to popularize the measure, all tended to militate against it. It would be difficult, indeed, to mention any substantial number of metropolitan newspapers or journals of importance which had even a good word for the bill. The exceptions to this general statement were so few as to make them more than conspicuous. A comparison of the editorials in New York newspapers published on the date after the first distribution of the Glass bill as introduced in the House showed perhaps without any exception either an absolute misunderstanding on the part of those who wrote these articles as to the actual content of the measure, or else an entire lack of comprehension of the purposes and objects of the legislation.

This was perhaps the most regrettable case of hasty misjudgment on a measure of international importance that the American press has been guilty of during the past two or three decades. It might perhaps have been expected that this general chorus of denunciation would be somewhat moderated as a better understanding was developed concerning the intent of the Federal Reserve Act and as the text of the measure became more widely available. In a few cases that was of course true, but in the majority the increasing bitterness of the political struggle as to the passage of the measure appeared to have put it out of the question to get any careful or detailed analysis of its terms.

Development of Opinion

With the press adopting the point of view that has thus been described, it was evidently not to be expected that anything of a helpful nature would for some time be obtained. Criticism, however, became gradually more specific and rather more intelligent. It centered itself first wholly upon the regional form of the proposed organization and of course upon the alleged difficulty of maintaining the discount rate policy throughout the nation. Next to this the proposal to force the banks into the system, whether with or against their will, came in for severe denunciation. In the more strictly banking publications, indeed, this compulsory character of the proposed measure was given first place. Reserve city publications accordingly developed a local view of the effect of the deposit provisions of the law and accordingly attacked the plan to transfer the reserve deposits of the country into the new reserve institutions. Severe criticism was directed at the proposed composition of the Federal Reserve Board, which, it was alleged, would be the nesting place for politicians who would therefore come into control of the resources of the country, and, it was alleged, would abuse this power for the purpose of making dangerous or unsound loans. Another

type of criticism related to the lack of centralization which was furnished by the law and to the presumed fact that new districts into which the country would be divided would not be "self-contained" since such districts would have to obtain relief, at least in times of stress, from other parts of the country, their own resources being inadequate at periods of crop-moving and perhaps at other times, and so it was contended that the act would have an injurious rather than a helpful effect. It would, some believed, tend to bring about a general breakdown of the previously existing machinery of crop-moving, while failing to substitute anything more efficient. The provision which the new measure carried for inter-federal-reserve bank rediscounting was regarded as ineffectual so that grave harm was looked for. On the whole, the charge that political considerations would control both in the Federal Reserve Board and among the government directors of the several reserve banks, and that in consequence the several institutions would be ineffectual and corrupt, was the staple of argument with the press in general. The more technical phases of the law, its provisions for currency issue, the unwise bestowal of the quality of government currency or obligations upon the new notes, were touched upon only incidentally and sporadically by a few newspapers and other journals. Even among these, however, the desire to criticize and find fault predominated and there were comparatively few who had even a qualified commendation to express for any portion of the law. It might thus be fairly said that the Federal Reserve Act passed to the statute book not only without the approval or support of the banking community but without the aid or indorsement of the majority of the economic thinkers of the country, and that in addition it was, so far as the press was concerned, perhaps the most generally denounced measure that had been placed before the country for a decade or more. It in fact went to the statute book against the almost unanimous opposition of the combined press of the country, regardless

of apparent political faith and regardless also of ownership or public appeal. It was undoubtedly true that a few hide-bound Democratic newspapers in different parts of the country praised the proposed law, many of them doing so without much knowledge. In not a few cases these extended their approbation to features of the measure which, on the whole, were undesirable. Intelligent support was encountered but rarely, and when rendered was for the most part a product of more or less uninfluential individuals and journals. Had President Wilson paid the slightest attention either to the bankers, the economists, the press in general, or, it must be added, to the politicians of his own party and the members of the Cabinet who were close to him, he would never have supported the proposed measure. Its adoption may, in fact, be ascribed almost exclusively to the unswerving determination of the President to secure the early adoption of a currency and banking reform measure. Having once for all decided upon the Federal Reserve Act, he neither paid any attention to unsound and biased criticism of the sort already described nor to the suggestions of those who might well have been listened to in connection with amendments and modifications. Indeed, it was practically out of the question to obtain from him approval for any substantial alterations after the bill had once been given its definitive form by the House of Representatives. With the united opposition and antagonism which existed practically throughout the country, it is safe to say that nothing except such single-minded determination on the part of the Chief Executive, who was at that time practically the dictator of his party, could ever have carried the bill through to success as a law.

Relation to Future Management

One striking element in the general current of public opinion that was particularly worthy of note was seen in the attitude of those bankers who were already expecting to become

in some way affiliated with the operation of the federal reserve system. Superficial evidence shows that from various dates in the autumn of 1912 onward members of the banking community had resigned themselves to the adoption of the Reserve Act and had mentally become prospective operators and managers of reserve banks. It is well known that during the spring of 1913, and even before the Federal Reserve Board had been appointed, banking interests in some of the more important districts of the country had devoted themselves with great detail to questions of personnel, parceling out the different directorships and executive places within their control and seeking to determine how they would throw their influence as regards the appointment of government directorate within their own districts, as well as probably members of the Federal Reserve Board. It is therefore very interesting to note a fact of which much more will be said in later chapters. This was that the reserve system was eventually placed for operation very largely in the hands of persons who had antagonized the adoption of the measure and many of whom had been hostile to it from start to finish. This astonishing fact makes the system in many ways unique as perhaps the only banking system whose organization was put into the hands of and controlled by its enemies, or at all events by those who had previously been inimical to this particular kind of measure. Later on when the Federal Reserve Board was selected it appeared that of the five appointed members one had been strongly hostile to the act throughout its legislative history, one had been an active and prominent member of an organization which as elsewhere seen was severe in its opposition to the Federal Reserve Act (the National Citizens' League), a third had early declared himself as positively devoted to the idea of a central bank, while of the remaining two only one could be said to have been positively and actively friendly to the federal reserve proposal. Of the two ex-officio members, the Secretary of the Treasury and the Comptroller of the Currency, the former

had taken an active part against the measure in its early days, as has already been seen, while the latter had been instrumental in seeking to reshape the terms of the administrative section of the bill so as to retain as much power as possible in his own hands

Future Directors Antagonistic

As the discussion developed it became plainer and plainer that in what related to the federal reserve districts and district cities there was no support for the new measure. Of the men who later became directors in the several reserve banks it is safe to say that a large proportion during the year 1912 took active ground against it. One subsequent federal reserve agent had remained in Washington until the very closing of the struggle for the purpose of opposing the reserve provisions, another had been locally active in maintaining the organization of the National Citizens' League and in promulgating ideas opposed to the Glass measure, another had been so outraged at the ideas embodied in the Glass bill as to be unable to exchange ordinary civilities with some of those engaged in the work connected with the measure. Of the later governors and directors of reserve banks a very substantial number had taken an active and leading part in the criticism of and attack on the bill during 1912, a situation which was notably characteristic in several of the larger cities of the country. Why the authorities eventually determined to place the management of the system so largely in the hands of those who had been opposed to it is an interesting question to which the answer is perhaps psychological rather than political. At this point the subject is discussed not in its administrative bearings, which are later to be reviewed with care, but merely as indicating the character of the attitude adopted toward the bill by the community and the very considerable discouragements to which its proponents were subjected by reason of the fact that, as they early perceived, it was likely to be next

impossible to find any advocacy or even friendliness for the cause among those who quite probably might be called upon to organize the new banks

Effect of Antagonism

Under these conditions as they may have been, and be the cause of this widespread and all but universal antagonism the effect of mistaken propaganda or of professional dislike for new ideas or of some other factor, the fact remains that it was present and that as the bill advanced toward the statute books the cumulative effect of the hostility of almost the entire financial public was very strong. It was not at all strange that either Mr. Wilson or his immediate associates, knowing upon them would rest the duty of applying and enforcing the law, and not merely that of securing its adoption, would have felt doubt and hesitation concerning the outcome of what, with such labor and pains, they were doing. The fact that they received practically no support whatever from any element of the press, except perhaps the most hidebound of the Democratic newspapers, added in no small degree to the unpleasantness of the situation, particularly as in various places it appeared that the more partisan members of the press were not willing to admit to their news columns any facts and arguments tending toward the support of the Federal Reserve

APPENDIX A TO CHAPTER XVIII

STATEMENT OF MR. W. P. G. HARDING, OF BIRMINGHAM, ALABAMA

In my judgment, the principal points of weakness in our present banking system lie

- a) In what may be called the pyramiding of reserves
- b) In the lack of elasticity of our national bank note currency

The answers to succeeding questions will cover this

I do not know of any measures now before Congress which would, in my judgment, meet all the requirements of the situation. I

believe that a satisfactory bill could be drafted from the report of the National Monetary Commission, taking that report as a basis

4 No

5 I believe that there should be established a central bank for the United States, and that such a bank should deal only with other banks and with the United States government. In my judgment, control of such a bank could be so distributed as to avoid danger of monopoly, but in view of the fact that the Democratic platform does not admit of any consideration of a single central bank, I think the best alternative would be the establishment of several regional banks, such banks to carry the reserves of all the banks, state and national, located within their respective zones. Ten or twelve such banks would probably be sufficient, and as the area of the United States is so large, each bank would serve a territory as large as any of the European countries, except Russia.

6 I think that the present bond secured currency should be maintained in circulation, but doubt the wisdom of permitting it to be increased in volume. Existing banks might be prohibited from increasing their bond secured currency, and new banks be prohibited from issuing any. The present bank note currency could be retired in 1930 when the 2 per cent bonds securing the bulk of it fall due.

7. I think that the present reserve provisions of the national bank law are unsatisfactory and dangerous. A country bank is required to carry on hand, in lawful money, six per cent of its deposit liabilities, and can carry nine per cent in banks in reserve cities which are not necessarily large financial centers, but may be towns of 25,000 population or over, which are designated as reserve cities upon the application of three-fourths of the national banks doing business therein. Banks in such cities are required to keep a reserve of twenty-five per cent, one half in cash and the other half with their own reserve agents, which under the law must be banks located in the central reserve cities of New York, Chicago, and St. Louis, which in turn must carry an actual cash reserve of twenty-five per cent. The effect of this law is to concentrate the bank reserves of the country in these three cities, chiefly in New York, so that in ordinary times they have a plethora of funds, which are loaned to a large extent upon stock exchange securities. When money is needed by the interior banks for crop moving purposes or for other reasons, the cash of the ordinary reserve cities is depleted, and they in turn draw upon the central reserve cities. The panic of 1907 illustrates the danger of our present system very forcibly, inasmuch as it was precipitated by strained conditions

in our chief reserve city, New York, the position of the country banks, / as a rule, being entirely sound. A central bank, doing business only with the government, and with other banks, or regional banks taking the place of a single central bank, would obviate this danger by removing the cause.

8 I believe that the dealings of the United States Treasury should be entirely with a central bank, or with the regional banks, if a central bank should not be established.

9 and 10 In my opinion there should be, if possible, government supervision of state banks as well as national banks, and as all commercial banks do a collection and exchange business, it is therefore probable that they are doing an interstate business, which would subject them to Federal supervision. The national bank laws wisely make limitations as to the amount of loans to one person, firm, or corporation, making the amount bear a fixed relation to the capital and surplus. It is highly desirable that this rule be adopted by state banks, and in my judgment the amount of deposits a bank is permitted to receive from one person or corporation, as well as the amount of its aggregate deposits, should also bear a fixed relation to its capital and surplus. Very large deposits are of course tempting to a bank, but they are oftentimes an element of great weakness, particularly where a large account is carried in a bank with small capital and surplus, subject to the check of one individual. If the amount to which a bank may become the creditor of a single concern is subject to regulation, it seems to me equally proper that there should be some limit placed upon the amount to which it may become a debtor, proportionate of course, to the amount of the bank's capital and surplus.

In view of the fact that a large number of national banks have savings departments, I would suggest that such departments be recognized by statute, and I would also suggest the advisability of clothing the National banks, under proper restrictions with trust company powers. Many of the larger national banks already have what is practically a trust department by having their stockholders own all the stock in an allied trust company. If the national banks themselves were permitted to do a trust business there would be no occasion for combinations of this kind.

Respectfully submitted,

(Signed) W P G HARDING,
President First National Bank,
Birmingham, Alabama

January 31, 1913

APPENDIX B TO CHAPTER XVIII

STATEMENT OF MR W A SCOTT, OF THE UNIVERSITY OF WISCONSIN

Course in Commerce
W A Scott, Director
December 31, 1912

Hon Carter Glass,
House of Representatives,
Washington, D C

My Dear Sir

1 In my opinion there are four fundamental defects in our present banking system

- (a) Our independent Treasury System which is a disturbing influence on the money market
- (b) Our bond secured bank note issues which render our currency inelastic
- (c) Our system of scattered reserves which promotes and intensifies panics
- (d) Control of our money market by special interests

2 — — — — —

3 In my opinion the plan of the Monetary Commission would be excellent if modified in the following particulars

(a) Not more than one-third of the members of the Board of Directors of the National Reserve Association should be appointed by District Associations. The other two-thirds should be appointed by the Government of the United States in such a manner as to prevent political appointments and to secure adequate representation of the agricultural, industrial and commercial interests of the country. These ends could be accomplished by putting the appointments in the hands of a board which would represent the Government but not be subject to political pressure and by limiting the appointments of such a board to a list of candidates submitted by the leading agricultural, industrial and commercial interests of the country

(b) Banks should be permitted to discount directly with the National Reserve Association, i e without the mediation of local Associations, bills of exchange and bank acceptances maturing in 90 days or less, representing the movement of goods from producers to consumers and bearing the endorsements of the bank presenting them for discount

(c) The National Reserve Association should not be permitted to discount the direct obligations of banks, and Sec 28 of the plan should be omitted

(d) The line between commercial and investment paper should be more carefully drawn than it is in the Monetary Commission's plan. This could be done by giving preference in discounting to the commercial bill of exchange as distinguished from promissory notes, and by a more careful and adequate definition of commercial paper

4 I am sending herewith the outlines of a plan for a central bank which is mostly my own work, and also one which I assisted Mr E E Garrison, of Madison, Wisconsin, to work out. I think a law could be worked out along one of these lines which would accomplish the desired ends

I believe that a workable plan could also be produced in which the control of the proposed institution would be divided between the United States Government, the banks, and the business public instead of being exclusively in the hands of Government as in the plans herewith submitted. I have gone sufficiently far in working out such a plan to be confident of its practicability

I also feel sure that the functions assigned to the Bank of the United States in one of the plans herewith submitted, could be performed by local organizations supervised and controlled by a central board, which would not be a bank in any proper sense of the term but simply an agency of local organizations for the doing in common of certain things, like the issue of notes, and the administration of reserves, which cannot be well and adequately done without cooperation on a national scale between all the institutions concerned. I have assisted in the preparation of a plan along this line which will be submitted for your consideration from other sources

5 I believe that a central bank is the best means for the accomplishment of the desired ends, firstly, because experience in other countries has demonstrated the practicability and efficiency of such an institution for precisely the kind of work here under consideration. By the use of this means of reform experimentation would be reduced to a minimum. While no foreign plan could be adopted here without great modifications, foreign experience could help us greatly in all the fundamental details. Secondly, the functions to be performed are national in their scope and naturally and logically call for a single national institution for their accomplishment. The issue of a perfectly elastic currency, the most efficient administration of the country's

specie reserves, the performance of banking operations for the United States Government, and the regulation of credit conditions in the interests of all classes and sections are *national*, not local functions, and they must be performed with an eye single to the interests of the entire nation. In my judgment local organizations pure and simple cannot perform these functions and such organizations federated for common purposes are not likely to be so efficient and satisfactory as a strong central institution.

A central bank can be most efficient when it is free to do business with the general public as well as with banking institutions. Indeed it is only when it has this power that it can efficiently regulate the market rate of discount and control the international movement of the precious metals. I believe that a central bank with such powers would be best for the United States, but I fear that the establishment of such an institution would be opposed by banks and banking interests on the ground that they would suffer from the competition of such an institution. Competition of a certain kind and to a certain degree would result from the establishment of such an institution, but such competition would be regulative and not repressive or destructive in its influence, and the resulting benefits to banks would in my judgment greatly outweigh any slight losses here and there and now and then experienced. However, I doubt if the bankers of the country generally could be convinced that this view of the matter is correct, and I, therefore, fear that an attempt to establish such an institution would fail. For this reason and because a central bankers' bank would accomplish the most essential reforms needed, I believe that it would be a mistake to attempt to pass a measure for the establishment of a central bank endowed with power to do business with the general public as well as with banks.

6 My objections to our bond-secured note circulation are presented [elsewhere]. For it I would substitute the notes of a central bank issued against commercial bills of exchange and gold. I would retire our present national bank note circulation by authorizing the central bank, or any substitute for it, to take over the two per cent bonds now deposited with the Comptroller of the Currency as security for such notes on condition of assuming the obligation of redeeming the notes, and to substitute its own notes for the national bank notes as fast as received and to cancel and retire the latter. I would authorize the Treasury Department to refund the two per cents into three per cents and the central bank or the substitute for it gradually to sell the three

per cents under conditions favorable to the government I would cause the Central Bank or the substitute for it to indemnify the Government for the additional interest charge involved in the refunding of the two per cents into three per cents

A slower, but in my judgment practicable, method of retiring the national bank notes would be the application of the surplus profits of the Central Bank or the substitute for it, to the purchase from national banks of the bonds now held against circulation and the retirement and cancellation of notes as fast as such bonds are acquired This plan would provide for the gradual payment of the major part of the public debt as well as for the retirement of the national bank notes

7 I consider our present reserve requirements very unsatisfactory In my judgment they should be rectified by requiring (a) that the cash, which under present regulations must be kept locked up in bank vaults, be deposited with a central bank or a central reserve institution, (b) that banks be required to hold against a considerable percentage of their deposits commercial bills of exchange of the kind that the central bank or the substitute for it would rediscount, and (c) that deposits should be classified as bankers' balances, individual deposits and time deposits and the percentage of required reserves be made different in these different classes and the present reserve distinction between country, reserve city and central reserve city banks be abolished

8 I believe that the United States Treasury should use the Central Bank or the substitute for it as its depository and financial and disbursing agent

9 In my judgment state institutions must be included in any scheme of banking reform that will prove efficient With the withdrawal of the issue privilege from national banks the only valid ground for differentiating them from state banks would be removed The handicap they now suffer in competition with state banks, because of their inability legally to accept real estate security should, therefore, be removed in case they are deprived of the issue privilege Furthermore state banks, in my judgment, should be allowed to enjoy the same rediscount and other privileges as national banks in connection with a central bank or a substitute for it, and some degree of joint or common supervision of both classes of institutions seems to me to be desirable

Very truly yours,
(Signed) WM A SCOTT

APPENDIX C TO CHAPTER XVIII

STATEMENT OF MR HORACE WHITE, OF NEW YORK CITY

Answer to Question No 1 The principal point is the lack of any central reserve fund adequate to assure bankers and depositors that all sound commercial paper can be promptly discounted at a fair rate of interest, and at all times

The second defect lies in the requirement that a banker in order to get circulating notes to meet any sudden and unusual demand for the same, must deposit securities which cost him more money than he obtains by such deposit, and that the process takes so much time that frequently the demand has passed away before the process can be completed

Answer to Question No 2 The change I would recommend for the first defect is the creation of a Central Reserve fund based on a capital of not less than one hundred million dollars, owned by the banks of the United States, or by such banks as agree to join together for that purpose, in proportion to their paid capital

For the second defect, I would abolish the present bond-secured currency and substitute in place of it a currency based on the commercial paper discounted by the banks

Answer to Question No 3 There is now a measure before Congress which I think would meet the requirements of the situation It is the bill reported by the National Monetary Commission for a National Reserve Association

Answer to Question No 4 I have not prepared any bill, plan, or formal recommendation, on this subject Nor did I have any share in the work of the National Monetary Commission

Answer to Question No 5 I believe in the proposed National Reserve Association I should not, however, give it a name which might create prejudice against it regardless of its real merits I think that the name of a Central Bank would create such prejudice

Answer to Question No 6 I think that the present bond secured currency should be maintained in circulation if the existing banks so desire but that no additions to it should be allowed, and that all such currency when retired by voluntary liquidation, or expiration of charters, or otherwise, should be cancelled and the bonds now held should be disposed of in the manner provided in the bill of the National Monetary Commission

Answer to Question No 7 The fact that the present reserve requirements of the national bank law frequently prove inadequate on a large scale seems to show that they are unsatisfactory In my judgment they can best be rectified in the manner provided in the bill of the National Monetary Commission

Answer to Question No 8 I think that the National Reserve Association should receive and pay out all the money collected and disbursed by the Government of the United States.

Answer to Question No 9 I think that opportunity should be given to State banks and Trust Companies to participate in the ownership and control of the National Reserve Association on the same terms as the national banks

Answer to Question No 10 I do not think that the present Governmental oversight of the banks needs to be strengthened

(Signed) HORACE WHITE

New York, Dec 21, 1912

CHAPTER XIX

IN THE SENATE COMMITTEE

Position of Chairman Owen

A peculiar condition of affairs¹ now existed in the Senate. Chairman Owen of the Banking and Currency Committee, as has been seen at an earlier point, after endeavoring to retard or to suspend action upon the new bill, or at all events to secure the substitution of a measure of his own, had eventually been obliged to introduce it in the form which had been determined upon by Chairman Glass in consultation with the President. He had, however, apparently lost none of his dislike of the measure.

Effective opposition to an administration bill which had passed the House of Representatives by a very large majority, was being pressed for passage by a determined President, and was supported by a corps of blindly devoted adherents who unquestioningly yielded obedience to the White House, was not easy. It was practically necessary to grant the bill at least a technically friendly reception and to insure it full and free consideration in Committee.

Decision to Defer Action

It appeared to be true that perhaps the best means of defeating the proposed measure would be the familiar one of delay. President Wilson by his intolerance and autocratic spirit had already aroused a considerable opposition to himself among the members of his own party. There were not a few of these members in the Senate who would gladly have rallied around the Secretary of State had the latter been will-

ing to afford them a nucleus of opposition. This, however, Mr Bryan was unwilling to do, and it was necessary therefore to hit upon some other means of developing an opposition. Eventually a canvass of the membership of the Committee and in some degree of the Senate itself showed the same division of opinion as in the House of Representatives, Bryan Democrats and Progressive Republicans being inclined to act together, while Conservative or regular Republicans were disposed to attack the measure far more vigorously than had their "regular" colleagues in the lower house. In the Committee itself a clique of opposition or Bryan Democrats and Progressive Republicans collaborated with those Democrats who were inclined to oppose the bill on personal grounds or because of dislike of President Wilson.

Apparently it was informally agreed that the best means of attack would be that of discrediting the House measure by subjecting it to attack both from outside and inside the Senate. To that end it was early announced that the Banking and Currency Committee would not only afford hearings on the bill but would admit to those hearings practically anyone.

Charge of Private Preparation

The point was raised very early in the history of the bill in the upper chamber that no hearings had been afforded with reference to the measure in the lower house. This of course was a statement without the slightest foundation, since, as has been seen in an earlier chapter, very extensive and elaborate hearings had been held by the Banking and Currency Committee through the sub-committee which sat during the months of January and February, 1913. It was true that there had been no hearings subsequent to the time when the Committee had perfected its bill, that is to say, no bill had been introduced into Congress or made public prior to the time when the hearings began. It was well known, however, by those who were invited to appear before the sub-committee of the House that

the purpose of their appearance was to comment upon pending banking and currency proposals in order that the Committee might be put into position to give due consideration in framing its own bill to the views of all those who were likely to be affected by it. The argument of the members of the banking community, when the measure was taken up in the Senate, therefore, was without basis, and perhaps would not have been very strongly urged had it not been for the feeling of various senators that it might be well to foment the dissatisfaction existing in the financial community. Be this as it may, the assertion that no hearings had been held was repeated many times both in and out of the upper chamber and largely as a result of it the Senate Banking and Currency Committee early announced its intention to give a hearing to all comers who might care to offer testimony before it. It was expressly announced with some show of appeal to the public that the Committee would not subpoena witnesses but that the hearings would be truly popular in the sense that they would be intended to give everyone an opportunity to be heard regardless of his affiliations or associations. The hearings were to be a field day of discussion primarily intended to permit those who believed that they had been overlooked in the past to voice their opinions, but intended also to permit members of the Banking and Currency Committee themselves to get information from the witness who might present testimony. The hearings before the Banking and Currency Committee of the Senate were thus in a peculiar sense another stage in the campaign which had raged around the Federal Reserve Act; and as they progressed, practically turned into an attack upon the bill as it had come from the House with the design of discrediting it.

Hearings Before Committee

This effort proceeded along three fairly distinct lines. The first was seen in an attempt to show that the measure had

been prepared in secret and without expert assistance and did not correspond to the views of the more capable members of the community who were in a position to pass upon the suggested banking and currency legislation. With this idea in mind various witnesses were invited to appear or voluntarily appeared who presented the thought of undue secrecy in the House of Representatives from many angles, and who criticized the proposed bill severely in its general structure. Negative criticism of this kind was not of much service as a means of discrediting the proposed measure and accordingly some of the witnesses thought it wiser to present plans of their own which might supersede the proposed enactment. Among these was Mr. Frank A. Vanderlip, who offered a scheme for a central bank analogous to that proposed in the Aldrich Monetary bill. Others who had already secured the introduction of bills presenting their views in Congress wrote letters transmitting their measures to the Committee or appeared in advocacy of them, or otherwise endeavored to call them to the attention of the members. It would be hard, of course, to say exactly what the outcome of this line of work really was, since an opinion on that subject depends much upon the judgment of the observer as to the merit of the plans proposed. It is at least fair to say that the burden of the testimony presented by the bankers and others was almost unanimously against the federal reserve proposal, and while not unanimously on the side of a central banking scheme, was nearly so. It was, however, a fact that the plans presented were usually in crude or incomplete form and that there was little to be expected from them without very detailed and extensive work of a scientific sort designed to develop a new bill.

Defects of Detail Alleged

The second line of onslaught upon the Federal Reserve bill was found in the effort to show that while the underlying

thought of the bill might be acceptable enough, it was exceedingly defective in detail and required an enormous number of amendments before the imperfect language of the proposed enactment could be regarded as at all worthy of consideration. Senator Owen, the chairman of the Committee, frequently in interviews with the press called attention to the hundreds of amendments which had been introduced into the bill as a result of the first cursory surveys made by the Banking and Currency Committee. It was of course true that a very large percentage of the amendments which were thus introduced and numbered in the House bill consisted of changes in punctuation, capitalization, and the like. Following the models of our older financial legislation, the Federal Reserve bill in the House had been made to begin each section with the word "that"—thus constituting a direct link or communication between it and the enacting clause, "Be it Enacted." Senator Owen early struck out the word "that" from the beginning of each paragraph and thus some 30 or so of his amendments were accumulated. It was undoubtedly true as the act proceeded further in the Senate that amendments of serious importance were introduced into it, but we are speaking now of the early battle which raged in the Banking and Currency Committee prior to the time when the matter was taken under any serious advisement.

An Alleged "Bargain"

A third line of attack upon the Federal Reserve bill was found in an effort to show that it was a product of a corrupt bargain between members of the Banking and Currency Committee and the House and the so-called "Wall Street interests," or that it had in some way been drafted or supplied by these Wall Street interests.¹ At a later date it was made plain that

¹ Various members of the Committee in interviews usually of an informal or unofficial sort gave expression to suspicion that the bill had been prepared under "Money Trust" influences or represented the work of sinister elements in the community. The charge that it had been framed without any hearings was repeatedly uttered both by members of the Senate and by outsiders, who seized upon this as an

one representative of the Wall Street interests to whom reference was constantly made, although not by name, was Mr Paul M Warburg, a member of the firm of Kuhn, Loeb and Company, of whom Chairman Glass at a later date wrote that he had no relation whatever with the drafting of the measure. The vague attempt to prove that some collusion or unwarranted influence of this kind had been exerted by the financial interests was continued from time to time and eventually came to a focus when the committee called before it the expert of the House Banking and Currency Committee, subjecting him to a cross-examination of several hours, one outstanding feature of which was found in the question whether or not the bill was a product of outside draftsmen or bankers not connected with the Committee who were permitted to have supplied or furnished it. To this question an absolute denial was rendered by the witness. As has been shown in earlier chapters, the hostility of the banking and financial community toward the proposed bill had been announced from the outset and every effort had been made by Chairman Glass to prevent the text of the measure from getting to the knowledge of financiers or others until such time as agreement had been reached upon its terms. There was not, in fact, the slightest scintilla of evidence beyond bare suspicion in support of this idea, and it was further true that the Banking and Currency Committee of the House had never at any time had before it a bill which could even indirectly be used as the model of the Federal Reserve Act save in so far as general community of idea and structure, running through nearly all of the pending banking measures, created a certain family resemblance between them. Spurious measures subsequently prepared and published as having been before the Banking and Currency Committee at the time the Federal Reserve Act was in prep-

indication that there had been some impropriety in connection with it. Nothing, however, could be discovered that tended in the least to bear out these charges, and the Committee was obliged to settle down to a discussion of the bill on its merits. Both Progressives and opposition Democrats having found themselves wholly unable to develop any scandal concerning the measure.

aration were at best extensive modifications of earlier drafts which in their first form bore only a distant resemblance to the work of the Committee. As a matter of fact, the Senate Banking and Currency Committee soon found it expedient to desist from this kind of onslaught, due to the fact that it could find so little to support its suspicions. Eventually, therefore, it was driven to a frontal attack upon the Reserve bill based upon direct expression of dislike or disapproval of its terms.

Several weeks had been necessary to ascertain groupings among members of the Committee.

Effort to Substitute a New Bill

Possibly the most significant development during the period in which the Federal Reserve Act was before the Senate Committee was found in the preparation of a revised draft of Sections 17, 19, and 29, whose purpose it was to alter the character of the note issue by making the reserve notes a legal tender and permitting them to be used as reserve by member banks. The intent apparently was to convert the national bank currency into something like a greenback issue and the plan was then in part a renewal of the ideas contained in the original McAdoo draft of the preceding spring, combined with an effort to obtain public support by providing for an easily attained form of reserve funds while at the same time bidding for the favor of the banks by giving them the opportunity at least of obtaining a better price for their bonds than they could otherwise expect to obtain.

The precise origin of this provision cannot be exactly stated but it was undoubtedly supported by the so-called Bryan Democrats in the Senate who were still inclined to believe that the bill as formulated in the House was too close to the asset currency ideas of earlier years and would allow the banks to get too large a profit from the function of note issue. The proposed plan was brought to the attention

of President Wilson and the Secretary of the Treasury and it was determined to take the matter up with the House Committee for the purpose of ascertaining how they would regard it. The President clearly regarded it as a hazardous innovation likely to result in largely cutting away the support which it was gradually gaining in non-partisan quarters throughout the country. Accordingly the proposed draft was placed before Chairman Glass, the present author being also called into consultation in connection with it.

The subject having been carefully canvassed, a memorandum analyzing the situation was prepared² and placed in the hands of the Secretary of the Treasury and transmitted to the President. It was then determined to disapprove the proposed change and to urge upon the Senate Committee the abandonment of the alterations which they had apparently decided to introduce. The memorandum in question practically embodied the argument against the proposal of the Senate Committee and may accordingly be printed as follows.

MEMORANDUM ON SENATE DRAFT³

The effect of the changes proposed would be to make the Federal Reserve notes a legal tender in payment of all debts and demands, public and private, and to permit them to be used as reserves by member banks, while National bank notes would be gradually converted into "Treasury notes," payable in gold at the Treasury Department, legal tender for all debts, and available as reserves by "any bank." The Government would stand behind the Treasury notes, taking up its own bonds from the banks which now hold them, and redeeming the notes on presentation in gold. The details of these changes and their results may now be developed in consecutive order.

GENERAL OPERATION OF PLAN

Assuming that all National banks entered the proposed system and availed themselves of its provisions, it would result that, at the

² By the author.

³ The sections of the revised draft of H. R. 7837 dealt with in this memorandum are sections 17 (page 46), 19 (page 57), and 29 (page 76). These sections bring about changes (1) in the status and character of the note issues provided for, (2) in the method of dealing with outstanding 2 per cent bonds held by national banks, and (3) in the relation of the Treasury to the notes and bonds and in its method of providing gold for redemption.

end of about twenty years, the two per cent bonds would all have been transferred to the Treasury Department under the provisions of Section 19, as now redrawn. The Treasury would presumably have issued about \$720,000,000 in Treasury notes, these to take the place of existing National Bank notes as the latter were presented for redemption (page 57, lines 1-6). For the current redemption of these notes the Government would be responsible, the banks having been relieved of their liability as they turned over the bonds at par, the Government simultaneously accepting responsibility for the notes protected by the bonds thus turned over. In order to maintain current redemption of these notes the Government would have had to supply itself with gold and under the provision would have done so as follows:

a By transferring "from the current funds of the Treasury to the reserve fund"—"an amount of gold equal to the volume of such circulating notes of the National banks so redeemed" (page 57, lines 7-11)

b By selling bonds or one year notes at not to exceed 3 per cent (page 77, lines 5-9), or by reselling at 3 per cent the old bonds taken over (page 56, lines 11-20) or issuing the latter as one year notes at 3 per cent (ibid)

GOVERNMENT TO PROVIDE GOLD

This makes it clear that whenever gold was demanded as the result of the presentation of the notes for redemption, the government would be obliged to draw gold from its current funds or else buy it by the issue of bonds. In other words, the maintenance of the country's fundamental gold supply, assuring the convertibility of its note issues, would be a burden resting upon the Government, whose expense would be entirely sustained by such Government.

Experience in the past shows that such maintenance of gold redemption is likely at times to become an exceedingly heavy burden, if either (1) heavy exportation of gold or (2) lack of confidence in general conditions prevail. During the years 1893-6 this was a very serious and costly matter. The amount of greenbacks then outstanding and which the then administration felt itself compelled to maintain convertible into gold was only \$348,000,000. These now remain intact under the new plan, of course, while to them would be added (presumably) \$720,000,000, so that the amount to be maintained at a parity would be about trebled. The fact that there is to be much more gold behind the outstanding issue to start with does not relieve

the situation, because the Secretary of the Treasury would be compelled to keep such gold up to a definite level. His problem of providing gold would, therefore, be even more serious than it was at a time when he was authorized to let the gold reserve run down as low as he thought consistent with safety. It is true that the higher level of gold behind the notes would tend to maintain confidence more strongly, but the danger arising from loss of confidence or adverse balance of trade requiring this country to furnish gold, would be equally as great *when once the movement of gold out of the Treasury had started*.

It is an axiomatic principle of banking that the duty and the burden of furnishing gold should be placed upon and borne by those who are responsible for the conditions which regulate the amount of gold needed or whose operations may result in producing an export of gold.

HOUSE AND SENATE CURRENCY PLANS

The effect of the proposed change, as contrasted with the terms of the bill passed by the House, would be very far-reaching. Under the House bill the issue of currency equal in amount to the National Bank notes, would be gradually transferred to the Federal Reserve banks, provided the country needed that amount of currency. If it needed less, the volume would shrink, if more, it would be expanded. Assuming that it would be about the same, this would mean that \$720,000,000 of commercial paper had had to be rediscounted with the Federal Reserve Banks or that the said banks would have received funds of some kind in exchange for which they would issue their notes, presumably the former. This would insure regulation of the amount of currency through the Federal Reserve banks, by the action of the Federal Reserve Board in refusing or permitting the issues applied for, but always in proportion to and based upon, the commercial paper put up to protect them. Actual regulatory power would thus be vested in the Board and in the banks. Under the proposed plan, the only regulatory authority would be found in the discretion of the Secretary of the Treasury, as limited and controlled by the actual fiscal condition of the Treasury, which might or might not correspond to the currency and credit needs of the country. The Federal Reserve banks would, moreover, be correspondingly curtailed in the amount of business naturally flowing to them, and their issues if any, would be a mere elastic fringe upon the underlying issues of Treasury notes.

In this connection it is worthy of notice that section 19 (page 57,

lines 7-15), which contemplates the transfer of gold from the current funds of the Treasury in an amount equal to the volume of the notes redeemed, would be impossible of enforcement if the plan were fully carried out of depositing all current funds in Federal Reserve banks. If this plan were not so carried out, it would still be questionable whether the Treasury would receive as "current funds" enough "gold" to enable it to comply with the requirements of the provision. The fact that it may receive enough today would not necessarily indicate that such would be the case in the future. In times past, when uncertainty concerning currency existed, payments to the Government have consisted largely of silver, National bank notes, and greenbacks. If they should in the future take this form, the Treasury would then be obliged to give up the idea of transferring such funds to the Redemption Division and would have to fall back directly upon the sale of bonds in order to provide itself with gold needed by it, unless it were prepared to go further and allow the gold reserve to shrink beyond the limits apparently contemplated by the bill as now redrawn. Just here a question may be asked: Would gold obtained by borrowing be reckoned as "current funds," or what would be the relationship between the status of the current funds and the gold reserve? Suppose that the current receipts of the Government consisted largely of greenbacks which themselves were a draft upon the gold reserve now held for their protection—would not then sales of bonds have to be immediately made, irrespective of whether a surplus existed or not in current funds, merely in order to provide the necessary gold? If so what would be the effect upon the general credit and confidence of the community?

RELATION TO RESERVES OF BANKS

Under the redrafted plan, Federal Reserve notes are available as reserves of member banks (page 46, line 11) while the new Treasury notes are available as reserves for "any bank" and both are legal tender in payment of all debts and demands, public and private. Apparently reliance is placed upon this provision for the purpose of keeping the notes outstanding. That is to say, it seems to be assumed that the Treasury notes and Federal Reserve notes would be held by banks as reserves and would not be presented for redemption very actively either to the Treasury or to the Federal Reserve banks themselves. Assuming this hypothesis to be correct, the results would be about as follows:

a Bank reserves would come to consist very largely of Treasury

notes and Federal Reserve Notes The amount of such lawful money reserves today fluctuates around \$950,000,000 If \$720,000,000 of Treasury notes were outstanding and were held in reserves by National banks, the reserves of such banks would consist largely of the notes If they were held partly by the National banks and partly by the Federal Reserve banks, or partly also by State banks, the situation would be the same except that the notes would be somewhat more diffused In that case gold would have been squeezed out of these banks' reserves and would be either in actual circulation or might have gone into the Treasury Department In time of any stringency or difficulty it certainly would not have gone to the Treasury, but the effect of filling the reserves with these notes would be to lead either to the hoarding of the gold or to its shipment abroad There can be little doubt that the effect of the provision, therefore, would be to reduce the actual gold "in sight "

b Inasmuch as the notes of the Federal Reserve banks may be held by member banks as reserves and are issuable upon commercial paper rediscounted with the Federal Reserve banks, there would be a very large loophole for inflation, due to the making of loans by banks which, in turn, gave rise to rediscounts at Federal Reserve banks, taken in notes, the notes resulting therefrom being in turn stored in the vaults of the member banks and thus giving rise to a basis for fresh loans to individuals As the Federal Reserve notes are payable to the Government, both the banks and individuals could use them in that way and as they increased in amount, they might be in part so used instead of being held largely as reserves If so used they would diminish the amount of gold otherwise payable to the Government, so that the Government itself would be obliged to call upon Federal Reserve banks for the redemption of these notes When such notes were redeemed, a corresponding draft would be made upon the gold holdings of the Federal Reserve banks, so that in order to recoup themselves they would, resorting to the cheapest method, present their holdings of Treasury notes to the Treasury for redemption in gold, thereby compelling the Treasury to supply more gold from its current funds, or in lieu of doing so, to provide itself with gold by selling bonds

The inevitable conclusion from a scrutiny of the Bill seems to be that although the Government, through the Federal Reserve Board, would have no check whatever upon the volume of the outstanding notes (except in so far as perhaps related to the excess of Federal Reserve notes issued over and above the new Treasury notes) and

could not, therefore, restrict the amount of issues either by refusing to grant applications based upon commercial paper as under the House Bill, or, by altering the rate of discount chargeable at Federal Reserve banks, it would be obliged to supply the gold for the country to any extent that was needed in order to back up the outstanding obligations created by member banks and those created by Federal Reserve banks through the rediscounting of paper subject to no check of serious importance. The Federal Reserve banks would, of course, have to observe the requirements as to their own reserves laid down in the law and to that extent would be controlled in their actions, but this check would be greatly weakened by the fact that their reserves might consist of Treasury notes instead of gold.

If the assumption made above (that the new notes of both classes went into bank reserves and were held there to a very considerable extent) should not prove to be sound, and if the banks and individuals, distrusting the new currency, should refuse to make use of the notes as reserves to any very large degree, the result would be to keep the notes in current circulation, which would mean that they would be regularly and actively turned into the Treasury either for redemption or as current payments, which, under the plan, would bring about a necessity for redemption as between the different departments of the Treasury itself. In that event the supposed "profit" to be made by keeping the notes outstanding and "saving the interest on them" would entirely disappear and the Treasury would be constantly hampered by the necessity of getting gold from some source. This difficulty would gradually increase as the amount of bank notes taken over and converted into Treasury notes increased. If at any time there was the slightest tendency to deficit conditions, or if large payments constituting a heavy draft upon Treasury resources had to be made, or if public credit were somewhat impaired, the difficulty of keeping up the convertibility of the notes would be very serious and at best costly.

EFFECT OF PLAN ON BANKS

One phase of the plan that deserves some attention is the effect of the plan upon the banks in their relation to the system. Undoubtedly the promise of redemption of their bonds at par would operate to bring them into the system. Under the provision as it now stands, however, it would seem that this would be lost. Section 19 provides (page 57, line 11) that the Secretary of the Treasury is to assume the redemption of the notes "of any National bank." As the words

"member bank" are elsewhere used in the Act, this language apparently refers to banks which are "National" at the time of the passage of the law. Apparently then the inducement to banks to enter the system is sacrificed. Even if this were changed to apply only to member banks, it is doubtful whether the provision in its present form would be wise. Banks presumably could leave the system at any time, just as under the old form of the Bill, and as the effect of the new provision would presumably be that of keeping the 2 per cent bonds at or near par, they might decide to do so at any time that suited their convenience. The result would be to render the system very much less stable than that provided in the House Bill where, although the banks are fully protected at the maturity of the bonds, they are expected to cooperate meanwhile in making the system successful, under the practical penalty of seeing their bonds deteriorate if they should leave the system in considerable numbers. While therefore it would take considerable detailed analysis to estimate the exact effect of the new provision upon the disposition of banks to join or to leave the system, it may safely be said that the general result of it would be to render the system decidedly less stable than that provided under the House bill. For example, if one-half of the bonds had been taken over by the Government by the end of ten years, a movement of banks out of the system would be very much easier than under the House bill, should such a movement be set on foot as a result of fear regarding the solvency of the system and its ability to maintain gold redemption.

MARKET FOR BONDS

While the 2 per cent bonds would be artificially sustained to a very considerable degree under the provisions of the Act as now drawn, it is a fair question what would be the effect of the proposed plan upon other classes of bonds. Two new classes of bonds are created under the redrafted provisions (1) 3 per cent interest bonds due July 1, 1933, or (2) one-year notes, renewable from year to year until July 1, 1933, bearing interest at 3 per cent. One of the chief criticisms of the House Bill has been that the 3 per cent bonds it provided for would not bring par in the market. If this be true, the bonds to be sold by the Treasury in either of the forms mentioned above would not bring par, while the Treasury might be a very great disturber of the bond market through its constant sales or retirement of bonds and notes. Whether it could by such operations succeed in getting par for the new classes of bonds or succeed in keeping them at par,

no one can predict Would the new Act contemplate a sale of bonds at less than par if necessary? If so, it should be specifically so stated If the Federal Reserve banks were called upon to finance the bond operations of the Treasury necessitated by the requirement that it supply gold, they would have it in their power at any time to practically put the Treasury in such a position as to necessitate an issue of such bonds or notes and to handle the securities at such price as they saw fit It seems exceedingly doubtful whether any class of banks should thus be given a whip hand over the Treasury Department both as to compelling sales of bonds and as to practically fixing their price and the market for them

AMBIGUITIES OF THE BILL

The language employed in the new sections does not seem to be self-consistent One such apparent inconsistency has already been noted in connection with the question of "current funds" out of which the Treasury, although required to deposit its funds in Federal Reserve banks, would have to supply the gold to be transferred to the Redemption Division unless it were willing to sell bonds Another difficulty seems to be found in section 29 (page 77, lines 1-11) where the Secretary of the Treasury is authorized to "exchange for gold Treasury gold notes payable in gold" Do these gold notes mean the same as the Treasury notes provided for in the earlier sections, and if so, how would the exchange referred to strengthen the Department? Or is this an authorization of a new type of notes—the "gold notes"? Other difficulties in the language occur from place to place, but need no comment at this point, as the objections already made, if considered, would necessitate revision, while, if not considered, the other ambiguities would be of purely minor character as compared with those already referred to

GENERAL PREJUDICE

It seems certain that the provisions of the Bill as redrafted would give grounds for opponents of the measure to appeal to general prejudice on the subject of gold redemption, Government paper currency, and the like Inasmuch as the Federal Reserve notes are given an entirely new and different status, while an entirely new type of currency is provided for (the new Treasury note) an entirely novel bond redemption provision is introduced A large field would be opened for the creation of artificial hostility to the measure and for misrepresentation by those who are opposed to any legislation at the

present time It seems highly probable that the introduction of the new provisions would greatly confuse and complicate the whole situation as regards the Bill At the present time the tightness of the money situation is well known, and it is a notorious fact that gold exports are likely to occur, and that our means of protecting ourselves against such a withdrawal does not compare with those of foreign nations If the new provisions should be resolved upon, although they, of course, would not go into effect immediately, but would only gradually become operative, they would undoubtedly tend to accelerate the disposition to ship gold and would be availed of by those who were desirous of making their profit out of the situation to bring about such a consequence Even if such provisions were to be enacted, it would seem far less hazardous to keep them separate from the general banking bill, and to incorporate them in a distinct and independent statute

SUMMARY

Summing up what has been said, it would appear that the following points are applicable to the proposed provisions

- 1 The new sections would throw upon the Government the necessity of maintaining gold redemption and the entire cost of it

- 2 This necessity and cost would grow greater from year to year

- 3 They would greatly limit the sphere of activity of the Federal Reserve banks

- 4 To that extent they would limit the power of the Federal Reserve Board to control inflationary tendencies

- 5 They would, by their provision for use of notes in reserves, immensely enlarge the possibility of an expansion of credit through the accumulation of such notes in reserves

- 6 In proportion as this condition came into existence, it would tend to drive gold abroad.

- 7 As gold went abroad (or as the notes were more actively presented to the Government for redemption, when distrust of their goodness was felt) the burden possibly to be thrown upon the Government in providing gold or in stemming an outward movement of gold would be increased

- 8 The elasticity of the Federal Reserve note issue, as well as the activity of the Federal Reserve banks in the markets, would be or might be greatly damaged in consequence of the foregoing considerations

- 9 The inter-relation of the Treasury notes and the Federal Reserve

notes is not made clear, and requires very much more study if any such provision is to be adopted

10 The effect of the provisions upon the movement of banks into and out of the system is uncertain, but quite obviously dangerous to the stability of the system

11 The provisions for the sale of bonds and notes are inadequate to furnish a proper protection to the Treasury Department and should be completely reworded

12 The possibility of popular misunderstanding and prejudice growing out of these provisions is very considerable

SUPPLEMENTARY STATEMENT

Careful study of the effect of gold redemption, instead of lawful money redemption, gives rise to very serious doubt whether, under all the circumstances, it will be wise to make an absolute compulsory provision for the convertibility of all forms of currency into gold. Although the United States has a very strong gold position, it might easily place itself, especially during the period of transition, in such a situation that other countries could draw upon it in an undue degree for gold. During the first years of the new system, therefore, it would seem far more prudent that the redemption of Federal Reserve notes should be made in lawful money or in gold, if the latter be demanded by the holder of the note. It is probable that this provision would very greatly reduce the number of gold redemptions called for, except under unusual conditions, while it would meet every objection that can legitimately be made to the present form of the Bill.

Compromise Outcome

Although the dominating factors in the Democratic wing of the Senate Committee had apparently fairly well reached a conclusion in favor of the redraft already referred to, they eventually yielded in part. The provision authorizing the use of federal reserve notes in member bank reserves was retained, although in a changed form, but the plan for making the government assume the burden of gold redemption and of converting national bank notes into legal tender Treasury notes was in part abandoned, notwithstanding that features of it persisted in the final draft. It was not until the bill had gone through the Senate with many of these elements still

retained, and had been referred to the Conference Committee, that it proved possible to eliminate the hazardous sections entirely, and to restore the measure to substantially the form which had been given it in the House bill. The persistence of the scheme for making federal reserve notes available as bank reserves was remarkable, for it had behind it undoubtedly the same interests which had originally urged the Aldrich plan, developed as that measure was upon the idea of note issues to be used in this way. The features of the plan which had to do with the redemption of bonds and the conversion of national bank notes were undoubtedly intended to win the support of the smaller banks, while the notion of making all notes government legal tender issues was a still further development of the concessions already made to Mr Bryan and his wing of the party at the time when the federal reserve notes had originally been announced as obligations of the government. Whether these elements could have been entirely eliminated in the Committee or not, it would be difficult to say. The political situation in the Senate was so uncertain that absolute insistence upon the elimination of the sections referred to might perhaps have resulted in a serious break in the administration's forces with the possible defeat of the measure. Indeed, at the time that this proposal made its appearance in its final form—November, 1913—the question of getting enough votes on the floor of the Senate to pass the bill at all was fairly serious. Close counts made in a preliminary way had apparently indicated that not more than a majority of one or two votes could be relied upon in the event of absolute and final test at that particular stage of the measure's progress. Enough work, however, was done with the Committee and with other members of the Senate to indicate the position of the administration and in consequence the tacit arrangement was made that when the bill went to Conference Committee, after being finished on the floor, it should be revised to eliminate the offending sections or what re-

mained of them. It was at all events practicable somewhat to break up the proposed plan and to eliminate certain of its worst features, leaving the rest for later treatment. As the event showed, this policy was wise, since it resulted in the final restoration of the measure to its original form. It had become evident that not very much could be expected of the Banking and Currency Committee of the Senate, owing to the great divisions of view within that body and that the measure would practically have to take its chance without the united support even of the Democrats of the organization.

The Final Report

The Senate Committee in reporting on the conclusions arrived at eventually found itself unable to agree upon any definite verdict. What would ordinarily have been presented as a Committee report was simply laid before the Senate as "views" presented by Mr. Owen on behalf of himself and a section of the Committee including Messrs. O'Gorman, Reed, Pomerene, Shafroth, and Hollis, six in all, who, according to the chairman's statement, had agreed to put their joint opinion in the form of a "memorandum." After reviewing the work that had been done by the House Banking and Currency Committee, by the National Monetary Commission, by Chairman Pujo in the Money Trust inquiry, and by Chairman Glass as head of the sub-committee on Banking and Currency, as well as the hearings that the Senate Committee itself had conducted, the memorandum proceeded to state that all the elements in the Committee had agreed upon the following points.

- 1 The necessity for greater concentration in banking reserves
- 2 The volume of such reserves
- 3 The capital of the proposed banks
- 4 The mobilization of the reserves
- 5 The promotion of an open discount market.
- 6 Provision for elastic currency

- 7 The view that federal reserve notes should be the obligations of the United States
- 8 The idea that the system should be a regional organization rather than a central bank
- 9 The control of the system by the government

Disagreements were noted between the sections of the Committee upon the following points

- 1 The number of federal reserve banks to be created
- 2 The method of subscribing to the stock of such banks
- 3 The method of electing the directors
- 4 The method of administering the several reserve banks

The differences of opinion, it was stated, were due in the main to the existence of "two schools of thought," one part of the Committee believing in a central bank administered by a central board, and the other part of the Committee proposing to establish a number of comparatively independent district banks administered by boards of directors representing the several districts but under the strict control of the government

Only Changes in Detail Needed

The memorandum recognized, however that in order to accomplish either of these ends certain essential features were necessary, they being the same that had already often been set forth and had been explained at length in the report of the House Banking and Currency Committee. It was only, said the memorandum in the matter of details of one kind or another and of changes in language that the principal modifications in the House bill were called for. Among those modifications which were thus set forth was a change in the system of clearing checks and drafts the Senate Committee providing for a charge to be fixed by the Federal Reserve Board to cover the cost of collection. The memorandum also went on to describe at great length the conditions under which

the Organization Committee was to act, providing that membership in the new system should be compulsory and should promptly be accepted by every national bank within sixty days after the passage of the act. Reserve cities were to be maintained as previously existing, but each member bank was required to hold reserves varying from 12 to 18 per cent against demand deposits and 5 per cent against time deposits. The total transfer of reserves was authorized to be made in much the same way as had been required by the Federal Reserve bill as adopted by the House. A complex provision for the election of directors of federal reserve banks was introduced and various complexities as to the increase and decrease of capital stock by reserve banks were also added. Some changes were made in the possible composition of the Federal Reserve Board by giving the President power to fill temporary vacancies during recesses of Congress. The Federal Reserve Board was given power to authorize member banks to use federal reserve notes as reserve and to grant trust powers to national banks upon application. One administrative change of very considerable importance was made by the Senate when it took the control of the issue and retirement of federal reserve notes out of the hands of the Board and replaced it in the hands of the Comptroller of the Currency, although subject to the supervision and regulation of the Board. Another change of large significance was made in Section 14 by authorizing reserve banks subject to the permission of the Federal Reserve Board to discount the direct notes of members secured by Stock Exchange collateral up to three-quarters of the value of such collateral. The powers of the federal reserve banks in open-market dealings were slightly altered and one or two undesirable changes made with respect to the powers of federal reserve banks in dealing with one another. Thus, for example, the reserve banks were given powers to establish accounts with one another, "for exchange purposes," the apparent purpose of this provision being to

give to some reserve banks functions which others did not have in carrying interdistrict funds. Changes were made in the methods of holding collateral protection against federal reserve notes in the hands of federal reserve agents and an important alteration was made in the method of retiring the bonds held by the existing national banks. It was provided in this connection that the national banks might transfer to the Secretary of the Treasury their 2 per cent bonds and receive in exchange 3 per cent bonds or one-year notes bearing 3 per cent. In such case the Secretary of the Treasury was to assume the responsibility for redeeming the notes outstanding, taking them in at a rate not to exceed \$36,000,000 per annum. As these circulating notes were canceled and redeemed, the Federal Reserve Board was to issue an equal amount of federal reserve notes and the bonds or notes which had been issued by the Treasury in lieu of the 2 per cent bonds were then to be held in trust for the federal reserve bank which was issuing its own notes to take the place of the retired national bank currency. A number of changes were also made in connection with national bank examinations and more or less important innovations in language were introduced at many points as well as a great number of unimportant changes in language, many of them undesirable and subsequently surrendered in Conference Committee. The outstanding change made by the Senate was that of limiting the total number of reserve banks which might be established to eight.

CHAPTER XX

THE SENATE DEBATE

House and Senate Type of Discussion

Of recent years debates on economic measures in the House of Representatives have often been perfunctory and conventional, a mere opportunity to go on record, or get "leave to print" something for free distribution to constituents. Senate debates have more usually been serious, permitting an opportunity for thoughtful and detailed study of pending issues. This difference in treatment between the two houses has in some degree been the result of difference in rules of debate and in a measure the outcome of natural differences between the two bodies in structure, size, temper, and in the ability of members.

The superiority in debate ought naturally, in the case of the Federal Reserve Act, to have gone to the House, since it was there that the bill had originated and had assumed its characteristic aspect. The reverse, however, continued to be the case, and the Senate debate while accomplishing little or nothing in actual results or changes in the language of the bill, was, as often, far superior to the general mental caliber of discussion in the lower chamber. President Wilson and his Cabinet working together finally succeeded in welding the Senate Democrats for once into a fairly well-constructed and obedient machine, and though at times on the verge of breakdown, were able to enforce administration views upon the legislative body as a whole, and to secure in the long run a favorable vote, though by a margin only of 20. At one time it had seemed from a canvass that there was a favorable majority of only one.

While the Senate debate might probably about as well have been dispensed with entirely, so far as any effect either on the measure itself or on the minds of members themselves was concerned, the discussion was of peculiar significance because of its appeal to the country. In a very special sense it was an outburst of feeling on the part of the Old Guard Republicans, who felt themselves outraged by the perception that they had been mastered and beaten by a rank outsider whom the accident of popular favor had placed in the White House. They saw themselves defeated at their own game, and the realization was peculiarly bitter because the subject at issue was one on which the Democratic party had long been considered especially untrustworthy. Of the old-line Republican members most were wise enough to recognize the real merits of the Federal Reserve Act, but such recognition only served to embitter them in their opposition.¹

Last Stand of Opponents

Perhaps the most striking feature of the Senate debate was found in this very effort to make a last appeal to the country and to bring to bear upon the President the general consensus of an aroused public opinion which would subject him to a powerful party demand that the bill be laid aside, or at all events very greatly modified so as to eliminate the elements which were objectionable to the banking community. Long before the measure had entered the Senate in any formal or official way, there had been a most careful examination of the personnel of the Senate in order to find out approximately how the different members were disposed to vote. Secretary McAdoo had done much work in "lining up" the different recalcitrants in the Democratic party, although there were those who suggested that his efforts had offended more votes than they had won over. The powerful influence of Secretary

¹ This was not true of all. Senator John W. Weeks, probably better informed on banking and currency than most of his colleagues and himself a former member of the National Monetary Commission, voted in favor of the bill.

Bryan was, as already observed, also exerted in behalf of the measure, and in every feasible way attempt was made to bring about a stronger organization of Democratic Senators, for the fact that there had been so much dissension in the Senate Committee on Banking and Currency was of course alarming from a party standpoint

Republicans, on the other hand, were almost equally uncertain about the situation. Although their opponents had a technical majority, there had long been in the Senate a certain body of Democratic members who could be relied upon to vote upon most currency questions with the Republicans. At the outset it seemed to them possible that, in view of the great power of the banking and financial interests which was now being thrown against the bill, they might be able to get together a working majority opposed to it. Perhaps this majority could be used effectively in amending or modifying the measure into a form which would lead to a presidential veto. The situation was accordingly recognized from the opening of the session and there was lively political controversy and scheming long before the measure reached the floor. Republicans hoped to organize a body of conservative Democratic and anti-Wilson Senators who, working hand in hand with their own men, would defeat the bill.

Appeal to Public

Thus it was that the actual discussion in the Senate was more than usually direct in its appeal to the public at large, being designed expressly for the purpose of encouraging support or opposition for the measure not merely among the membership of the legislative body, but among the outside public. Some senators expressly stated that they were addressing the country at large and not their colleagues and a few of the speeches were unusually careful in their preparation, and elaborate in their method of dealing with the whole subject. It was regrettable that in these circumstances the

debate could not have attained a higher level of economic and financial capacity and have been freer from the taint of bitter partisanship. But this was perhaps too much to ask. Disasters of all kinds, inflation and contraction, greenbackism, and all financial unsoundness were predicted by opposition members, while advocates of the bill, although in many cases evidently unwilling, were disposed to present the measure as almost the revelation of a new economic gospel written down upon tablets of stone by a superior authority. Taking the discussion as a whole, it could not be regarded as very illuminating, nor did it result in modifying the structure of the new measure in any very essential particulars. Nevertheless, it represented a historic struggle, the turning point in a controversy of generations past and deserves therefore a somewhat detailed review which is the more significant because of the many myths which have developed during the few years since the adoption of the act, with respect to the positions assumed by various members.

Debate in the Senate Opens

A message from the House of Representatives informed the Senate on September 18 that the bill had passed the lower chamber. It was then read twice, by title, and upon the motion of Chairman Owen was referred to the Committee on Banking and Currency. Hearings which have already been reviewed were then begun with the understanding that they would end on October 25. In the meantime a rather impatient attitude was shown by some Senators who pointed to the urgency of speedy legislation. The bankers of the country were in a difficult position in view of the uncertainty of legislation which was so vitally to affect their business, and members of the Committee occasionally appeared on the floor of the Senate to inform it that the work of the Committee was progressing and the hearings could not be ended before the 25th of October, owing to the number of those who wished to be heard.

Demand for a Caucus

On November 10, Senator Hitchcock, a member of the Committee, appeared in the Senate to report the facts as to a new situation which had arisen. Since the hearings had been closed, Mr. Hitchcock reported, the Committee had been in session for two weeks. Progress was so encouraging that there was general expectation of a report to be prepared in a short time. A number of changes had, however, been made by a majority vote of the Committee, the divisions running 7 to 5 and occasionally 9 to 2. Among the more important matters that had thus been voted upon were a proposal to have the Committee report in favor of 4 regional reserve banks instead of 12, in favor of giving to the government a majority on the boards of directors, of having the stock in the reserve banks offered to the public in popular subscription, of making all federal reserve notes issued under the bill redeemable in gold only, and other matters. Said Mr. Hitchcock:

At this juncture outside influences began to be felt upon the Committee. The reactionary period set in. We were told that the President could not accept the decision reached by the majority of the Committee and we were urged to retrace our steps.²

Mr. Hitchcock, in explaining his attitude, set forth that, although he understood well the force of such an appeal and did not criticize those yielding to it for doing so, he could not justify any change of opinion on his own part except in a case of political expediency. In his judgment, however, there was no political or partisan issue in this particular measure. He had therefore declined to change his vote, with the result that the situation in the Committee was deadlocked. He furthermore protested against a proposed conference which was to be called by the Democrats to deal with this situation. It would, Mr. Hitchcock thought, amount to a caucus. By its decisions he would not permit himself to be bound against

² Congressional Record, 63d Congress, 1st Session, p. 5881.

his conviction, and he had accordingly determined to lay the matter before the whole Senate—it being the proper place to discuss the bill. He therefore proposed that the Senate take the matter out of the hands of the Committee by directing it to report a few days later.

Reply of "Conference" Advocates

Mr Vardaman and Mr Swanson replied, the latter having been responsible for the circulation of the petition for a banking conference. Mr Swanson explained that it was this peculiar situation in the Committee that had seemed to render a conference worth while, and that the occasion was not to be a caucus but merely a conference designed to advise with and get the opinions of the Democratic members—of the Committee especially.

Senator Reed, speaking in general on the importance of currency legislation and the difficulties involved in it, reverted to the impatience evidenced by the country, saying

There seems to have been a sort of general impression given to the country that the drafting and enactment of a banking and currency bill was a sort of a summer-day picnic excursion, to be indulged as a diversion from the ordinarily serious business of legislation.¹

Ten days later, on November 20, Mr Stone reported to the Senate that he had been informed by the chairman of the Committee, Mr. Owen, that the Committee would be ready to report the Banking and Currency bill on Saturday, the 22nd of November, and when Mr Hitchcock was asked whether he was in accord with the understanding that the bill was to be reported on Saturday, he replied that an agreement had been reached that the two factions of the Committee should report as they pleased with a statement of their disagreement and their inability to come to an understanding. It was the further understanding that the bill would be reported without

¹ *Ibid.*, p. 5883

recommendation and that preference be given to amendments recommended by either division of the Committee indifferently

The Bill Reported to the Senate

On November 22 Mr Owen did, in fact, report from the Committee on Banking and Currency the bill before it and submitted a formal written report ⁴

When Mr Owen on the same day proceeded to move that the bill be laid before the Senate for consideration, discussion arose as to whether the bill could be placed upon the calendar unless by request, since it had not been reported by a majority Mr Owen explained that the bill had been reported, but that the report was without recommendation The bill was thereupon assigned a place on the calendar and Mr Owen's motion was agreed to

Mr Owen addressed the Senate, as in committee of the whole, on Monday, November 24, saying

On Saturday last I gave notice that today I should move to amend the House bill by striking out all after the enacting clause and substituting the House bill as amended by the Democratic section of the committee ⁵

This was done for parliamentary convenience, the proposed substitute representing the old bill with a number of unimportant changes as to phraseology and only a few important ones

Mr. Owen's Defense

In an introductory way Mr Owen referred to what he considered the chief defect and unavoidable consequence of the old banking system This was the recurrence of panics After the tremendous national catastrophe of 1907, which,

⁴ "The committee on currency and banking to which was referred the bill (H R 7837) to provide for the establishment of Federal reserve banks, for furnishing an elastic currency, etc having considered the measure, report the same to the Senate without recommendation" (Sen Rep 133) It was decided at the same session that the views of the two sections were to be printed as Parts 2 and 3 of the report

⁵ *Ibid*, p 599a

according to the estimate of Senator Aldrich, cost the country over two billion dollars, the entire country demanded relief. Since then different attempts at legislation had been made, as, e.g., the Aldrich bill, the numerous investigations carried on by the National Monetary Committee, the work of the Pujo Committee, and others. The chairman of the House Committee on Banking and Currency, Mr. Glass, had begun consideration of this matter with a view of framing a bill in 1912. In numerous hearings representatives of great banking interests, commercial houses, and financial experts had been heard. Before the bill was ever submitted it was considered by many thoughtful men, amendments suggested, and finally brought into the Committee on Banking and Currency. It was then discussed in the Democratic conference, and afterwards on the floor of the House, while members of the Senate Committee were already giving it attention and close study since September 2, when they began their formal hearings. These hearings as concluded on October 25 were submitted to the Senate in three volumes covering 3,200 pages. Representatives of banks, of business interests, credit associations, clearing houses, and financial experts were heard at length. "So, Mr. President," he remarked, "it is impossible for anyone to contend that the Congress of the United States has not given this matter the most infinite pains and considerate care."⁶

Although the members of the Senate Committee did not come to an agreement on the amendments which they thought should be made to the bill, they had agreed on a good many questions of fundamental and far-reaching importance, as, for example, the necessity for greater centralization, the extent to which the volume of the reserves should be concentrated, the mobilization of such reserves, an open discount market, and others. The points of difference were seen in the number of the banks, the method of subscribing to the stock,

⁶ *Ibid.*, p. 5994

the method of selecting the directors of the reserve banks, and the method of administration Mr Owen remarked

These differences arose, as I have said, because there were two schools of thought in the committee, one believing in a central bank, administered by the Government, and the other believing with the House of Representatives and with the President that these banks should be regional banks, controlled by the bankers under the supervisory control of the Government^r

To accomplish the purposes of the bill, which Mr Owen enumerated as stability of commerce, availability of credit, constant employment of the productive energies of the country, and abolition of the practice of pyramiding reserves, the following great fundamentals are to be recognized as essential and necessary first, the proper concentration and mobilization of the bank reserves under control of the banks themselves, safeguarded by strong government supervision, second, a suitable banking capital with double liability as a margin of safety for the reserve banks and the deposits of the government, which are expected to be placed in the regional banks, third, insurance of an elastic currency against liquid commercial paper, fourth, establishment of an open market, and finally, for the protection of the gold reserves, the raising of the interest rate through the central board.

The Regional Plan

As to the mechanism by which it was proposed to accomplish these results, Mr Owen pointed to the regional scheme. As over against the provision of the House bill of not less than 12 he proposed to have a system of not less than 8 banks. Even if we were to provide for 12 banks, Mr. Owen said, we should still have a less number many times over than had Europe. Referring to the administration of the banks, the directors and their selection, Mr Owen raised the question at

^r *Ibid.*, p. 5994

issue between the two sections of the Committee—whether the banks or the government should elect the majority of the directors. The reason why he and his Democratic colleagues believed it wise to have the banks name the majority, was the fact that the banks had to contribute the capital, and keep their reserves in these regional banks.

It is our duty to them, it is our duty to the country to put upon them the responsibility of safeguarding their own funds by giving them a majority of the board of directors in those banks.^a

If conditions should be made too harsh we should be met in all human likelihood with a wholesale withdrawal from the system.

Another division of view occurred with reference to the subscription to the stock of the reserve banks, which Mr. Owen and his colleagues thought should be open only to banks. The institutions would have to submit to double liability for the same reason of the vast responsibility on these banks which will hold not only the reserves of the country but also the funds of the government.

The plan and purpose of this bill, to give stability, etc. all of those considerations urge that the Federal reserve banks should be banks for banks, bankers' banks, and not a public bank competing with the banks for business.^b

Mobilization

As to the two conceptions of mobilization and concentration which are often used synonymously, Mr. Owen explained that the one did not necessarily involve the other. Mobilization of the reserves, even if they are concentrated, exists only in case they are kept in liquid form as gold, legal tender money, or short-term commercial bills and if an open discount market is provided for.

^a *Ibid.*, p. 5995

^b *Ibid.*, p. 5995

Coming to the note issue provided in the bill, Mr. Owen considered the notes better secured than in any banking system in the world. Enumerating the safeguards behind the notes, he indicated twelve in all. As of equal importance, Mr. Owen referred to the provision authorizing the Federal Reserve Board to raise the interest rate. It would, he said, protect the gold reserves of the country, would work against undue inflation and expansion, and would check speculation. It would furthermore tend to stabilize the rate of interest and would thus have a beneficial effect upon business life. "Violent fluctuations of the rate have up to now," said he, "been one of the greatest injuries to business."

Concerning the earnings of the banks, Mr. Owen thought that the stockholders should get 6 per cent on their capital, while all the remaining portion of the earnings should be used for building up a surplus and should belong to the government. As to the reserves to be kept in reserve cities, he thought it wise to yield to the opinion, frequently expressed by bankers, that instead of 18, 15 per cent was a safe enough margin.

The refunding provision for the 2 per cent government bonds was amended by Mr. Owen and his group, so as to provide a new feature by authorizing "federal reserve bank notes." The opposition of the country banks to the clearing provision of the House bill, which called for the clearing of checks at par, was to be taken care of by the amendment which allowed a reasonable charge to be ascertained and fixed by the Federal Reserve Board.

Section 27 was struck out as both sections of the Committee as well as the banks all over the country were unanimously against it.

Mr. Owen agreed that there might be several proposals originating with the other section of the Committee which were meritorious, and which at the proper time might be accepted. He expressed his confidence that the difference between the two sections would be reconciled by the Senate.

without any great difficulty. He appealed to his colleagues that they give the most urgent and immediate attention to the bill. The whole country was waiting. Banks were accumulating their reserves, because they did not know what this bill was going to be. Business men found it difficult in the meantime to secure the accommodations which they actually required.

Views of Mr. Cummins

Senator Cummins, in reply, first raised the question whether state banks could enter the system without violating their own state laws, he thought such violation likely in the majority of cases. Mr. Owen's reply brought out, first, that membership was left entirely optional and that a state bank would no doubt exercise its own pleasure in entering the system, and certainly could do so, if it chose, by agreement or contract. The discussion ended after a short explanation of the redemption provision.

Argument of Mr. Hitchcock

Mr. Hitchcock, in opening his reply to Mr. Owen and the majority of the Committee, referred favorably to the President's action in making the banking and currency reform an administration measure. Were it not for the President, he averred, agitation and discussion might have continued for some time to come. He thought it remarkable that the House had succeeded in sending to the Senate so good a bill, considering the difficulties of the situation. On the other hand, there were apparent shortcomings, as was best proved by the fact that every member of the Senate Committee had voted for changes which amounted in the aggregate to more than one-half of the original matter. Mr. Hitchcock considered it fortunate that both sections of the Senate Committee had to a considerable extent proposed amendments to the same sections. "If it had chanced that we had selected different sections to

amend, I fear there would be no part at all of the original House bill here for consideration"¹⁰

He did not consider it a misfortune that the measure was not brought in with a unanimous or compromise report, for thus the Senate was in a position to consider the bill with better results, and could judge after both sides had been duly presented, which of the differing views offered to it was most likely to lead to the desired and most favorable results

Number of Reserve Banks

Taking up the first point of controversy, the number of reserve banks, Mr Hitchcock gave his reasons for supporting a limit of four. First of all he thought that European experience with one central bank in all the larger countries should speak for itself. He could see no logical argument for more than four banks. If eight, then just as well to have ten or twelve or more. Four banks were justified, for they would include the three great central reserve cities, New York, Chicago, and St. Louis, as well as a large district on the Pacific Coast with San Francisco as its natural center. Division into a greater number of districts would magnify demands for currency in some parts of the country when there might be idle funds in another part, a condition which might be brought about at certain seasons.

Mr Hitchcock desired that the government nominate the majority of the directors on the board of the banks, because he considered the banks a public utility not controlled by money-making motives or representing merely a form of banking "trust." For the same reason he was against having the reserve banks owned by the member banks but wanted to have the subscription to the stock open to the public. He further thought that it would endanger the whole plan were Congress to force the banks to subscribe to the stock, since their earnings ran from 10 to 15 per cent, so that they would

¹⁰ *Ibid.*, p. 601g

not submit to a plan in which one-tenth of their capital would get a remuneration of only 5 or 6 per cent. He urged that each bank underwrite its share of the subscription and offer it to the public, which, in Mr. Hitchcock's opinion, would take it up readily. Under this plan it would be difficult to advocate more than four banks since the "puny and weak" banks would hardly pay a dividend.

Shifting Reserves

As to time required for shifting reserves, Mr. Hitchcock called for a longer period, thirty months, in which to effect the transfer gradually, so as to avoid the shock which would be produced by too sudden a change. To guard against discrimination by the reserve banks which might or might not discount paper, he provided that every individual bank, as a matter of right, have the privilege of discounting eligible paper up to the amount of its capital stock. A limited amount of paper having a maturity of six months was to be eligible. In regard to the rate of discount, he contended that his plan for fewer banks would stabilize rates the country over better than the plan of the other members.

One-half of the excess profits, he proposed, should go to the Treasury and the other half constitute a trust fund for the insurance of the depositors of the member banks, which, if it became excessive, might be discontinued by the Federal Reserve Board. Taking exception to the discretionary power of the Board which might or might not issue currency, Mr. Hitchcock recommended that the Board issue notes to any reserve bank that complied with the requirements as to the reserves to be kept behind the deposits and notes. This provision would be necessitated by the former one, according to which good paper must be discounted to a certain extent. The Board would still retain a restraining power in raising or lowering the rate of discount.

To be on the safe side Mr. Hitchcock deemed it wise to

raise the reserve requirement behind the notes to 45 per cent and against deposits to 35 per cent. The redemption provision was to read that the notes be redeemed in gold or gold certificates only. Senator Owen's change as to this was considered by Mr. Hitchcock a compromise which he could not understand, it providing that banks redeem the notes in gold or lawful money, but that when presented at the Treasury, they should be redeemed in gold only.

Refunding 2 per cent Bonds

In order to refund the 2 per cent government bonds, Mr. Hitchcock recommended that bonds bought from the national banks by the reserve banks be exchanged by the Treasury for 3 per cent one-year gold notes. He urged this provision particularly as a means of affording the reserve banks a way of securing gold, when wanted. While the bonds to be used in refunding would be one-year bonds, they would be so limited only for the purpose of making them marketable, the banks, however, to be under a contract with the Treasury to renew the issues from year to year for a period of twenty years.

Finally Mr. Hitchcock pointed to the advantage of his scheme, which by opening the subscription to the general public, could add an altogether new capital of \$106,000,000 to the country's banking funds.

Senator Shafroth

Mr. Shafroth further presented the viewpoint of the Owen section. He attacked the one central bank scheme, which in reality was the underlying idea of the Hitchcock plan, as another attempt at combination of capital, whose powerful effects could result in the greatest injury to enterprise. The vastness of the country and the fact that 40 per cent of the banking capital of the whole world belongs to the United States differentiated the situation in this country from that in the smaller European countries.

Mr Shafroth pointed to the contradiction in Mr Hitchcock's plan which on the one hand was, he said, based on the theory that the banks should be "people's banks" and therefore government-controlled, while on the other hand the reserve banks would not be allowed to receive any deposits other than the deposits of member banks and the funds of the Treasury. The combination, however, whereby the reserve banks would be controlled by a majority of bankers who were shareholders in the venture, whilst the Federal Reserve Board was to be exclusively a board of control, an official body, controlling the currency and the rate of interest, seemed to Mr Shafroth particularly well devised.

As banks deal in bonds, stocks and other securities, it is presumed that the knowledge upon the part of a banker on the Federal Reserve Board that the rate of discount will be raised or lowered would be taken advantage of by the interests which he represents, and thereby stocks and bonds would be either bought or sold by them with almost absolute certainty of a profit being realized.²¹

European banks, as Mr Shafroth observed, would object most strenuously to a banker's getting such advantage, and they are perfectly convinced that no banker should be allowed to become a director of their central banks.

As for the Hitchcock provision for redemption of notes in gold only, Mr Shafroth expressed his apprehension that it might help to intensify the strain on the gold supply of the world, which had expressed itself of late in the raising of the discount rate in all the European central banks.

When the rate of discount gets high throughout the world, it generally produces stagnation in business, commerce and enterprise. Consequently the least strain upon gold that can safely be made and yet maintain the gold standard comes nearest permitting business and enterprises to continue in a prosperous way.²²

²¹ *Ibid.*, p. 6024.

²² *Ibid.*, p. 6025.

He therefore preferred Mr Owen's proposal which would limit the strain on gold to the eight reserve banks without impairing the redemption of the notes in gold. It would, he thought, relieve the strain in as far as it would do away with the necessity for the banks to compete with the Treasury and with each other for gold and thereby permit a smaller margin of gold to make the redemption.

Mr Shafroth did not see any necessity for raising the reserve requirement, which in his opinion would not need to be specified at all were it not for the tradition of the country. Inasmuch, too, as a higher requirement would only mean so much the more strain on the gold supply than is necessary, a change of the provision was objectionable to him.

He considered that one of the greatest defects of the Hitchcock amendment was found in the provision which proposed a retirement of old currency without substituting a permanent new circulating medium. Because of the opinion which had found expression in the hearings, that there would not be enough commercial paper in the country to make the demand for currency efficient, Mr Owen's section of the committee had proposed the replacement of the retired currency by federal reserve bank notes.

The Newlands Proposal

On November 26, Mr Newlands explained a plan which he had introduced into the Senate in form of a resolution on the previous day.

So far as I am concerned, Mr President, my purpose is not to oppose but simply to modify, the pending bill, to extend the regional system therein provided so as to secure a regional reserve association in every State, and to unite these State reserve associations in a Federal association at Washington.²⁸

There was no doubt in Mr. Newlands' mind that the federal

²⁸ *Ibid.*, p. 603a

government had the authority, under the interstate commerce clause of the Constitution, to interfere also with state banking matters, "that the power of the nation over interstate commerce enables it to take hold of a state bank engaged in interstate exchange, just as it takes hold of a state railroad engaged in interstate transportation" The first effort, according to Mr Newlands, should be directed towards bringing about a harmony between state and national banks Why should the requirements for the one be less strict than for the other? The average of state bank reserves is figured to be $7\frac{3}{4}$ per cent, while the pending measure would require the percentage of the reserves behind deposits of national banks to be an average of $13\frac{1}{2}$ per cent He therefore included in his resolution a section, requiring the reserves of state banks to be 12 per cent of the deposits and he also recommended a definite proportion to be kept between capital and deposits, the capital to be equal to at least 12 per cent of the deposits

Having thus put the state banks "on a par" with the national banking system, Mr Newlands sought to bring about a union of all these banks through a system of state reserve associations

I believe that every State should have a robust individuality, that it should have its own bank system and its own commercial system, and that every State should have what may be termed a financial center It is essential to the completion of any civic organization"

Membership for both national and state banks would be compulsory A state reserve association would not need any capital Member banks being required to deposit with them one-third of their cash reserves, the total amount of the deposited reserves over the whole country would amount to \$500,000,000, divided equally among the 48 states it would give over \$10,000,000 to each association

That fund would enable such reserve association to take

¹⁴ *Ibid*, p 6033

hold of any panic or stringency , and through a system of rediscount of the commercial paper held by the State reserve association could furnish it with the additional money necessary to check the panic or stringency³⁶

Mr Newlands' plan also provided for a Federal Reserve Board at Washington, the membership to be drawn from these various 48 reserve associations Besides the government funds it would receive one-third of the reserves that had been deposited with the member banks Its function would be similar to the function of the Board provided for by the pending measure The chief difference between Mr Newlands' scheme and the pending one was, in his judgment, the number of banks "The other details of the bill can be easily adjusted, when that question is determined, and I am in favor of determining that basic question by an early vote in the Senate or in party conference"³⁸

Criticisms of Mr Reed

Mr Reed's speech treated mainly of the genesis of the bill He pointed to what he called the peculiarly difficult task of designing a scheme which had no counterpart anywhere in the world He enumerated the several changes which the bill was subjected to beginning from its early stage as the first Glass bill of June 26 up to its present substitute

The second (Glass) bill changed the first in 164 particulars Before the second bill reached the Senate it had been amended 57 times As the result of the hearings, the deliberations of the committee and the consideration of the Democratic conference, 340 additional amendments have been made So that it appears that since this bill found its way into Congress it has been amended 561 times³⁷

³⁶ *Ibid.*, p. 6034

³⁸ *Ibid.*, p. 6035

³⁷ Mr Reed had a table prepared and reprinted in the Record (Vol 51, pp. 175-178), showing the changes that had occurred between the four different stages House bill 6454, introduced June 26, known as "first Glass bill", House bill 7837, introduced August 29, known as "second Glass bill", House bill as amended in committee and House of Representatives, substitute for House bill 7837, reported by Owen branch of Senate Banking and Currency Committee and approved by Democratic Conference at Senate, printed December 1

The most difficult proposition, in Mr Reed's opinion, was to write such reserve provisions and provide for such a transfer as would least interfere with the country's business. In this regard he thought that the Committee did the most valuable service, as under the provision of the House bill a calamitous result would have been certain. The changes as proposed by him were that the Federal Reserve Board be empowered to authorize member banks, in case of temporary emergency, to use as part of their reserves federal reserve notes, and second, that banks be allowed to meet the primary reserve requirements of the bill by rediscounting up to the amount of one-half of the required reserves.

If we have solved that single problem, then all the time taken by the committee is fully justified, because not to have solved it would have been to produce a constriction of currency and credits calamitous in the extreme.¹⁸

As compared with the branch banking system, Mr Reed emphasized the virtues of the American independent system.

The unification of local pride, local interest and self-interest is the dominant principle of our banking system.

Even more important than the question of local interest is the fact that in this country each bank is independent from and in active rivalry with every other bank.

The pending bill did not interfere with these two dominant principles.

With the other section of the Committee Mr Reed had contended for a majority control by the government of the regional banks. But he reluctantly concurred in the conclusion of the majority, although only upon condition that certain amendments were adopted which would remove all possible danger. So, for example, a provision concerning class B directors, who shall be "representative of the general public interest," was amended as to provide that they shall be in fact

¹⁸ 63d Congress, 2d session, p. 170.

representatives of the business and agricultural classes As to the government funds, his section recommended changes which would not make it obligatory upon the Secretary of the Treasury to deposit all funds with the regional banks but would leave it to his discretion to withhold such funds if that course was prudent Mr Reed also referred to the powers of the Federal Reserve Board, which in his judgment had to be as large as possible, and he dwelt to some extent on the advantages to accrue, in consequence of this legislation, to the bankers of the country

Views of Mr. Weeks

Mr Weeks, in a speech on December 5, supported the Hitchcock amendment Personally, he confessed, he was an adherent of the central banking theory However, on account of the decided attitude of the Democratic party against it, he was willing to compromise and to adopt the Hitchcock plan of four banks Besides the compulsory rediscount provision he recommended that the same rate of discount be charged all over the country He also indorsed the provision eliminating the Secretary of Agriculture and the Comptroller of Currency from the Board for the reason that they would hardly be able to attend efficiently to both offices

As to the division of earnings, Mr Weeks could not support the Hitchcock plan of utilizing one-half of the excess profits for a guaranty fund

To take from a fund provided in this way moneys which really should go to the Government and insure all classes of deposits in all kinds of banks is simply saying to the average depositor Place your money where you can get the largest return on it and we will see that you make no loss²⁰

The balance of the earnings ought to be applied to the payment of the government debts As regards the foreign branch provision, Mr Weeks agreed with the Hitchcock amendment

²⁰ *Ibid.*, p 280

which raised the requirement as to the capital of a bank which wants to open a branch in a foreign country, to \$5,000,000, the requirement of \$1,000,000 being regarded as entirely inadequate

Senator Swanson on Mobilization

Senator Swanson took as his point of departure the need for mobilization of reserves and an elastic currency. He expressed his conviction that the system as proposed was wisely planned and that its adoption would greatly benefit the country. The capital and the resources of the regional banks, he figured, would amount to about one-fortieth of the banking capital and one-fortieth of the total banking resources of the country. "The plan is wisely drawn giving the banks sufficient capital and resources to accomplish what is desired, and yet not large enough to produce a monopoly or a dominating influence upon the money and bank credits."²⁰ Mr. Swanson criticized the New York banks for having expanded their loans during the panic of 1907, although they did not pay the interior banks the money due them. He further contended that it was a bank's duty, in case of its reserve falling below the legal requirement, to refrain from further loaning and to continue to pay out deposits on demand.

Senator Nelson on Currency

Mr. Nelson outlined the historic development of the currency system of this country, and continued with discussion whether the reserve banks ought to be allowed to pay interest on deposits which represented a surplus over the required reserves. Mr. Nelson was for abolishing the system of paying interest altogether and challenged the Owen section of the Committee for having omitted in the new print of their substitute the provision prohibiting the charging of interest. In the course of his speech he expressed his conviction that the

²⁰ *Ibid.*, p. 427

gravest mistake made was "that instead of having a system of regional reserve banks we ought to have a large central bank, of non-voting stock, subscribed by the people, under the absolute control of the Federal Government"²¹

The old division of opinion as to the refunding provision was again brought to the foreground, when Mr Nelson objected to the perpetuation of the rigid, bond-secured currency in any form

Defense of New York Banks

Mr Weeks in later remarks replying to Mr Swanson and others offered statistical data to support his contention that the banks of New York did what they could to cope with the panic of 1907. The policy of the European central banks in times of stringency had always been to expand their loans and if New York banks had done so to a slight degree they could only be commended. In regard to the question of currency issue, Mr Weeks thought himself justified in his opinion, after having investigated the situation here and there, that enough commercial paper would be forthcoming to supply the requirements²²

Comparison of Hitchcock and Owen Plans

Mr Nelson, on December 9, continued his speech of the previous day and compared section for section both the Hitchcock and Owen amendments. In regard to the administration feature, he could not understand why the same party which was so expressly opposed to the Money Trust proposed a system which left the ultimate control of the boards of the reserve banks to the banking interests. With Mr Hitchcock he urged against the Owen section of the Committee that the dividend of

²¹ *Ibid.*, p. 456

²² Another point thrown into the discussion was the contention so familiar in the House debate that the forced membership of national banks was unconstitutional. It was strongly refuted by Mr Williams. "I do not suppose that in all the history of the United States it was ever said that giving a man his free choice between remaining a privileged creature of the Federal law or not remaining one was taking his property without due process of law" (P. 424)

6 per cent would cause a higher rate of discount and would ultimately mean for the borrowing public a higher rate of interest on loans. In replying, Mr Shafroth stated the reason which prompted the Owen section to change the provision, the presumption, namely, that as the result of the 40 per cent excess profits which were to go to the member banks, these institutions would be operated for profit.

It seems to us when we cut out that, that we of necessity give to every member bank dealing with the Federal reserve bank the advantage of not having profits accumulate for the bank for the purpose of being divided among the member banks.²²

Mr Shafroth further called attention to the fact that while the Hitchcock bill called for a capital of \$100,000,000, the Owen bill called only for \$50,000,000, that therefore with the same reserves and public funds the tax upon the system would be under the Hitchcock plan \$5,000,000 in the way of dividends, whilst under the other it would be only \$3,000,000.

Proceeding, Mr Nelson pointed to the insurance fund, provided under the Hitchcock amendment, as an effective means of avoiding or stopping a panic. Mr Cummins regarded this fund as being of particularly high importance and wondered therefore whether it was not possible to make it a first charge upon the earnings of the banks. As to membership on the Board, both sections agreed that the Secretary of Agriculture and the Comptroller of Currency should be eliminated, a division of opinion occurring only in regard to the number of members, which the Hitchcock plan increased to nine. When Mr Nelson objected to the provision of the Owen bill empowering the Board to authorize member banks to count as part of their reserves federal reserve bank notes, Mr Shafroth replied by referring to the insufficiency of reserve money in case that the state banks enter the system. Mr Nelson furthermore supported the compulsory rediscount

²² *Ibid*, p 517

provision for the reason that he thought it necessary to safeguard against discrimination from the side of the reserve banks against member banks. Senator O'Gorman, in response, stated that the Owen section of the Committee, having this objection in mind, had changed the Glass bill so as to lodge a summary removal power with the Federal Reserve Board, which would make it impossible for an officer of a regional bank to discriminate against a member bank. Mr. Borah expressed his opinion to be that the government alone should have the power of expanding or contracting the currency.

Mr. Bristow's Criticism

Mr. Bristow, a member of the Committee, was not willing to acknowledge any evidence of merit in the House bill. "Its enactment as it came from the House would have been a national calamity."²⁴ He, too, was a staunch defender of a central banking scheme. The only serious objection to it was that it would place too great a power into the hand of one central organization. This was based on the assumption that it was to be owned and controlled by the banks.

But when we provide that the ownership of the stock of the central bank shall be by the people and not by the banks, and that its control shall be by the Government and not by the banks, then that objection vanishes.²⁵

Comparing the two plans with each other, he went on:

Theirs is a bankers' banking system, owned by the banks, controlled by the banks, and conducted almost wholly for the profit of the banks, while ours is a people's bank, owned by the general public, controlled by the Government and used to strengthen and fortify our great independent banking system.

Mr. Bristow argued strongly against the summary power of removal which the Owen group had put into their amendment.

²⁴ *Ibid.*, p. 527

²⁵ *Ibid.*, p. 528

in order to prevent discrimination against member banks "Such a policy opens the door to the widest political abuse and favoritism"²⁶

A sharp discussion centered around the issue of people's bank versus bankers' bank, and both Shafroth and Owen endeavored to bring about a better understanding of the reasons which had led them so decidedly to stand against a central bank with public subscription. The first point was that no bank would consider going into the system unless it was controlled by banks, secondly, should the people have the control of these banks they would become competitive banks, which was not their object. "We have competing banks. These 25,000 individual competitive banks are in fact, under the American system, the people's banks as they are now." What is needed is to provide a means by which the people's banks can fulfil their functions, getting instantly, when necessary, ready money, etc. It was primarily for that reason, said Mr. Owen, that the object of the bill was to establish a bankers' bank. But besides, the government funds would approximate about \$200,000,000 and

The Government of the United States in putting that vast fund into these Federal reserve banks ought to have such a safeguard as would be thrown around it by a double liability of the stockholders, and of stockholders whose financial reliability is beyond dispute.²⁷

Mr. McLean's Argument

Mr. McLean found his views altogether at variance with the views of the majority, and although he realized the futility of argument he at least wished to record his protest. The time for banking and currency legislation was particularly opportune, in his opinion, for the reason that he thought the new tariff needed to be given first a test before it be influenced

²⁶ *Ibid*, p. 530

²⁷ *Ibid*, p. 537

by other legislation. He ended with a statement of his own belief in a central bank as the best basis of reform²⁸

Mr. Sherman's Objections

Mr. Sherman of Illinois offered many objections to the measure, including the coercive membership feature, the centralized control of the Board, and the compulsory rediscount provision, but on the whole he was ready to vote for the Hitchcock bill, which by opening the banks to voluntary subscription recognized at least the basic right of private property

Burton for Central Bank

Mr. Burton's argument was entirely based on the presumption that a single central banking institution was the only commendable scheme

The Owen bill carries upon its face a frank admission of the fatal defects of the regional system, because it gives power to a board of central control to effect a readjustment of reserves between regional banks and to require enforced rediscounts²⁹

His arguments in favor of a single central bank were along the following lines (1) mobilization of reserves, (2) equitable, stable, and uniform discount rate, (3) management, (4) uni-

²⁸ There was considerable debate concerning the difference in the amendments as to the refunding and reserve provisions. Mr. Nelson's argument against the Owen amendment was that it meant but a perpetuation of the old system, "it is only swapping the national bank notes for these new notes based upon the same kind of bonds" (P. 599). He objected in particular to the feature which made it absolutely mandatory for the reserve banks to issue notes on the bonds which they purchase. Mr. Simmons urged that the reserve banks could buy bonds in the open market, for which they did not need to take out circulation, a fact which would give them a certain control over the currency. This was answered by Mr. Nelson, who said it was of no practical value. If the reserve banks should buy these bonds which were worth not more than 75 to 80 per cent of their face value they could do so and save them selves from a great loss, only by taking out circulation.

The provision of the Owen amendment according to which in lieu of cash the reserve banks might accept from the member banks one half of the required reserves in commercial paper, was considered a dangerous innovation. In its place the Hitchcock amendment provided for the transfer of funds over a longer period. Mr. Crawford took exception to both amendments for confining the business of reserve banks to banks only. He did not advocate competition but thought that the power, in case of emergency, to go over the heads of banks and deal with individuals would be a wholesome check.

²⁹ *Ibid.*, p. 667

form note issue, (5) the gold movement, (6) the credit of the government, (7) refunding operations, (8) clearing functions and domestic exchange. He dwelt in particular on the advantage which a central bank would possess in applying its gold policy. "There can be no doubt but that eight or twelve regional banks cannot act as effectively to control our gold supply as a central bank."⁸⁰ It was altogether inconceivable to Mr. Burton that any system should act to produce proper centralization in spite of being devised on a regional plan.

Referendum of Mr. Thompson

Mr. Thompson stated the results of an investigation which he had made in his own state, Kansas, with the result that not a single banker or business man was in favor of the Hitchcock proposition. It was argued against Mr. Hitchcock that on the 8th of April of the same year he had introduced a bill, after having made a study of banking systems in Europe, in which he had failed to let a single person outside the banks become a stockholder and in which he provided that every one of the nine directors of these reserve banks—of which there were to be not less than 20 and not more than 25—was to be elected by the banks. Against Mr. Owen, on the other hand, it was shown that as recently as the 26th of June he had declared in favor of public subscription. The latter defended himself on the ground that at that time it looked as if the banks would not enter the system. Mr. Hitchcock admitted that as soon as he saw his work—the bill of April 8th—in print, he found it bad and did not try to solicit support. As to the number of banks, Mr. Hitchcock agreed that there was no difference in principle. "It is simply a difference in mathematics, based upon experience."⁸¹

⁸⁰ *Ibid.*, p. 682

⁸¹ *Ibid.*, p. 702

The Cummins Amendment

Mr Cummins offered an amendment which he thought would meet the real issue between the Hitchcock and the Owen bill

to state the effect of the proposed changes, .
they would convert the capital stock of the Federal reserve banks from a coerced capital into a voluntary capital with the national banks holding the first chance to contribute, but with the hope that the people at large would furnish the greater part and transform these new banks from instrumentalities of the banking institutions of the country into instrumentalities of the Government They would substitute public control for private control²³

Mr Cummins, however, did not see the reason for revolutionary legislation, as he thought that the existing system could be made to work if the law regarding national banks were amended in three particulars first, by prohibiting any national bank from paying any interest whatever upon any demand deposit, secondly, by requiring that additional note issues be authorized only upon adequate security, and thirdly, a point upon which Mr Cummins laid most weight, that there be instituted a deposit guarantee fund to be raised by the levy of a tax upon the national banks Although not satisfied with either of the bills, Mr Cummins preferred the bill reported by Mr Hitchcock

It is, of course, because I believe that the regional banks or reserve banks ought to be controlled absolutely and completely by the Government of the country—that is, by all the people of the country—that I resist the proposal to compel the national banks to furnish the capital with which the reserve banks are to be conducted²⁴

Mr Cummins conceded that the government had the right, for example, to increase the reserves, which were to be regarded as a margin of safety and besides constituted a pro-

²³ *Ibid*, p 774

²⁴ *Ibid*, p 778

portion of the people's deposits, and he drew the distinction between them and the capital of the banks, contributed by the people who own the banks. An amendment as to the latter was very likely not to be regarded as valid.

I am appealing to my Democratic friends not to plunge the financial world of the United States into the confusion and uncertainty that would ensue if the validity of this statute should be called in question, and it remained for a judicial tribunal to say whether it was for the public welfare and necessary for the protection of the bank that a part of their capital should be taken and invested in the stock of another corporation."

Root on Notes and Inflation

Mr. Root in a three hours' speech expressed his objection to a note issue authorized by the government and his apprehension that the measure would give rise to undue inflation. Pleading for a stronger gold cover behind the notes and a more strictly limited note issue, he forecast possible events which might bring about gold export movements on a large scale, as, for example, when in case of a European war returned American securities would have to be paid for in gold.³⁴

Senator Root later defended his stand by urging that a tendency to inflation is always to be found

that there are many people who believe that it is the duty of the Government of the United States to print money and furnish it on easy terms to the people of the country, and who believe that it is not necessary to have that alleged money supported by anything but the fiat of the United States."

Under the powers of the Federal Reserve Board, so Mr. Root

³⁴ *Ibid*, p. 822

³⁵ It was maintained by members of the Hitchcock section that the loaning power of the banks would contract if they had to subscribe to stock, while Messrs. Owen and Shafroth argued that the release of funds would be brought about through the altered reserve requirements. Mr. Burton's questions concerned in particular the organization scheme of the provisions, the personnel of the Federal Reserve Board, the establishment of the banks, etc.

³⁶ *Ibid*, p. 967

maintained, this view can easily be put into operation "So, sir, it will have to be more than ordinary human nature that will enable this board to stand against the constant pressure for inflation that will be brought to bear upon them"⁸⁷ Mr Root meant thereby the pressure from the different sections of the country which are represented on the Board, "for where you have a board created with reference to sectional distribution, necessarily there is a representation of sections" Mr Newlands agreed with Mr Root in so far as he also considered values to be inflated by the disproportionate increase in the credits and the deposits as contrasted with the increase in population and business

Replies to Mr Root

Mr Owen took issue with Mr Root's inflation theory, by trying to prove that the new system would require even more cash for reserve purposes than the banks possessed, so that these would be compelled to rediscount As to Mr Root's apprehension of a shortage of gold, Mr Owen declared it unfounded "We can get gold whenever we want it and in whatever quantity we want it by paying the interest rate necessary to hire its use"⁸⁸ There followed another discussion relative to the guaranty fund, the amendment to Section 7

Mr Reed argued that the strength of the reserve banks consists not only in their capital but also in the reserves which they hold, "that the reserves of member banks deposited with reserve banks take on the nature of permanent capital and permanent resources"⁸⁹ He then replied to Mr Root's speech saying

I do not quarrel with those men who desire to make this bill so that by the terms of the law a check shall be placed upon the volume of currency, but I do take issue with those men who are willing to denounce the bill as an inflation

⁸⁷ *Ibid*, p 969

⁸⁸ *Ibid*, p 983

⁸⁹ *Ibid*, p 890

measure designed to inordinately swell the volume of currency, and as inevitably leading to a disastrous end⁴⁰

Both Mr Owen and Mr Williams replied to the assertions of Mr Root Mr Owen enumerated again the several safeguards behind the notes and Mr Williams explained their inherent expanding and contracting power

Discussion on December 16 was opened by Mr Bristow, who spoke in favor of a depositor's insurance fund Of the two provisions regarding the division of earnings and the depositor's guarantee fund, Mr Bristow preferred the Hitchcock amendment Mr Weeks, who was to talk against an insurance fund, was not yet ready to do so, the amendment therefore to section 7 passed over Mr Walsh thought it an appropriate time to offer a speech against Mr Cummins' assertion of unconstitutionality

General Debate Ended

Previous attempts to limit the general debate had been objected to and it was not until Wednesday, December 17, that a unanimous-consent agreement was accepted limiting—beginning with Thursday—each speaker to 15 minutes and fixing the date of final vote for Friday, December 19 As Mr Kern remarked, the general debate had consumed already about 80 hours of consideration and discussion

Every question involved has been discussed from every conceivable angle, every nook and corner of the field has been explored, reexplored and then explored again . . . The truth is that this debate has been carried on until there is nothing to be said on either side that has not already been said, and we have reached the stages of vain repetition and crimination and recrimination⁴¹

Mr Burton's speech on the essential quality of currency and credit and their relation to capital was admittedly not

⁴⁰ *Ibid*, p 891

⁴¹ *Ibid*, p 1034

intended chiefly for his fellow Senators, whom Mr Burton did not hold ignorant on these principles, but was uttered "because among the people there exist many grave misapprehensions upon the subject"⁴² Mr McCumber held that both bills omitted provisions against inflation Mr Gronna had similar apprehensions coupled with a strong distrust in a banking monopoly, which in his opinion was created by the Owen provision There ensued another encounter upon the question of guaranty of deposits with Mr Burton attacking it on the plane that banking business could not be compared to life insurance

Since the Senate vote had indicated that it adhered closely to the Owen draft of the bill, it occurred to Mr Hitchcock that he had better present the pending amendment and also the others as proposals to amend the draft of Senator Owen He therefore withdrew the amendment and proposed a modification of the Owen provision, so as to have the funds not administered by the Treasury but by the reserve banks themselves, since otherwise the state banks would be unfairly discriminated against Mr Owen, who did not oppose extending the benefits of these insurance funds to state banks, referred this matter to the conference of the Democrats before final action was to be taken on the bill Mr Hitchcock's amendment to include six months paper as eligible to discount was particularly supported by Mr Crawford, who argued against what he considered a discrimination of the smaller country banks, which would not be in a position to have much of the short-term paper in their portfolios The other side could utilize the argument that such a policy would only increase the chances for inflation The amendment was tabled, likewise a substitute containing the compulsory rediscount provision

Floor Amendments

On December 18 numerous amendments were entertained and quickly disposed of. Mr Hitchcock sought to modify the

⁴² *Ibid*, p 1037

Owen bill by various proposals all of which were tabled. Of the amendments offered by Mr. Owen, which were the result of a Democratic conference, there were a great number merely designed to improve the wording of the measure, there were others bringing about slight technical changes and also some which showed the influence of the discussion by embodying views as they were expressed on the floor. It was provided, for example, that members of the Federal Reserve Board, including the ex-officio members, should be not eligible during the time they are in office and two years thereafter to hold any position or employment by any member bank. The reserve requirement behind the notes was increased to 40 per cent. All of these amendments were adopted after but little discussion with the exception of one, the additional provision, namely, which authorized the Board to employ attorneys, experts, etc., necessary properly to conduct the business. It was attacked because, as opponents said, it would strengthen the partisan character of the Board by having its employees appointed and not subjected to the civil service examination. However, it was defended on the ground that it would be unfair and unjust to assume that the members of the Board would use their office as a means of rewarding petty politicians from one end of the country to the other. The necessity of getting the working machinery established as quickly as possible was urged. Mr. Owen furthermore pointed to the change in his draft, as against the House bill, in the omission of the provision that no more than two members should belong to the same party. It would have had, in his opinion, the undesired result of creating a bipartisan instead of a non-partisan Board.

Among more important amendments adopted in the evening, was the additional provision regarding the rediscount of agricultural paper running for six months. Some outside amendments were rejected, including Mr. Root's upon the note issue and Mr. Bristow's with his insurance fund provision.

Mr Newlands tried to get rid of the limitation of reserve banks, "not to exceed 12 in all", Mr Cummins introduced an amendment providing for limited business between the reserve banks and individuals or corporations directly Mr Weeks wished to utilize the surplus earnings for the liquidation of the public debt Mr Burton offered a series of amendments He was for striking out the reserve suspension clause in the section on the powers of the Federal Reserve Board, and for omitting the provision which allows the Board to authorize member banks to use as reserves federal reserve notes, he also wanted to leave out a clause permitting eligible paper to count as part of the reserves After all his amendments were rejected he offered to strike out all of the pending bill and introduced his own substitute, a bill which he had worked out on the principle of a central bank All these amendments were rejected

Adoption of Bill

Mr Owen now moved the adoption of his own general amendment, which meant acceptance by the Committee of the Whole It was agreed to and the bill was reported to the Senate As according to the rules it was possible to introduce amendments in the Senate again, several amendments were introduced and again voted upon Mr Jones's small amendment which was to give to the President the power of putting the employees of the Board under the civil service, was accepted Mr Bristow's guaranty fund amendment was lost again, likewise Mr Burton's attempt to strike out the section authorizing the Board to appoint attorneys, experts, etc, necessary for the conduct of business When Mr Hitchcock moved for the adoption of his bill as a whole, after it was read again, it was rejected with a small margin Mr Hitchcock expressed his satisfaction at the debate and declared that he felt himself after all justified in voting for the Owen bill, which he considered an improvement over the House bill Mr.

Weeks also assented to the Owen amendment. Not so Mr Bristow, who could not decide to depart from his standpoint of objection. The amendment by Mr La Follette, offered at the last minute, forbidding senators or representatives in Congress to serve on the Federal Reserve Board or at the directorate of the reserve banks, was accepted.

The bill finally passed the Senate by 54 yeas to 34 nays.

Recess Sought

The closing of the Senate debate by a vote in favor of the bill and especially by the satisfactory margin by which it was passed had not been positively forecast until within a very short time of the final ballot. In order to defeat the measure the usual expedient of asking for a recess had been resorted to by opponents shortly after the middle of December, the contention being urged that Congress had been in session for a great while and was desirous of returning home for the Christmas holidays. A careful canvass at that time seemed to show that the administration could not be sure of a majority of more than one or perhaps two members, with the probability that this majority would be lost if the members were to be allowed to return to their homes and to defer action accordingly. President Wilson accordingly let it be known that in no circumstances would he assent to such recess or adjournment prior to the taking of a ballot. It was the last necessary exhibition of that firmness and inflexibility on the part of the Executive which was so primarily responsible in compelling the adoption of the Federal Reserve Act and which worked so well as long as there was a moderate party majority which required only the oversight of a taskmaster to keep them in working order.

As the debate progressed, however, popular support had appeared more and more to veer to the side of the Federal Reserve Act. It is an unfortunate trait in American political life that nothing succeeds like success, and that when the

passage of a measure is assured there is usually a rush to side with the majority and so avoid the appearance of defeat. Yet as the federal reserve measure came to be more and more closely studied by bankers it appealed more and more strongly to the wiser among them. More and more it had begun to be recognized that the banking community, in order to get a genuine rectification of conditions, would have to consent to the surrender of the undesirable and dangerous elements which tended to vitiate the banking situation of the time. The conviction deepened that perhaps this was as favorable a moment for a thorough reorganization as any and that since we had gone so far we had perhaps better carry the attempt through to a successful conclusion. It may well be that if the actual vote on the Federal Reserve Act had been deferred to a later session it would have been even more strongly on the side of the measure, although the chances against such an outcome and in favor of a serious modification of its terms as a condition of its passing could not be ignored. The adoption of it without further delay was the part of political wisdom even had it not been urgent to end the unrest and uncertainty which had begun to develop among the financial community. There had been no time in all the previous history of the measure when it had stood so well with the nation at large as it did when it passed the Senate. True, the Senate Committee had greatly defaced and injured the measure, but public opinion when dealing with complex economic questions is necessarily prone to ignore details and to found itself largely upon broad essentials. The growth in favor which had been gained by the federal reserve measure was the result of a wider reading and a better understanding of its fundamental provisions. It implied the complete defeat of the selfish interests which had opposed its basic ideas and insured the successful remodeling of the measure in conference committee along lines which would eliminate its defects and preserve the more meritorious elements which had been developed during legislation.

CHAPTER XXI

CONFERENCE AND PASSAGE

Importance of Conference Committee

Inasmuch as the Federal Reserve Act as adopted by the Senate had assumed a form materially at variance with that which had been accepted in the House of Representatives, the work of the Conference Committee of the two houses assumed an unusual importance. As with all complex economic measures, so also it was true of the conference on the Federal Reserve Act that the net outcome might be either (1) the practical adoption of the bill as passed by the House, (2) the retention of the changes made by the Senate, (3) the adoption of some and the rejection of other important or significant alterations, or (4) the practical reconstruction and remodeling of the entire bill so as to substitute completely new provisions at essential points. Which one of these courses would be followed?

It has become an article of faith with many, desirous of "saving face" or distorting facts in the interest of party or personal advantage, that the result of the conference was either the second or the fourth of the alternative courses already indicated and that its net outcome was to substitute the Senate bill, with some entirely new provisions for that of the House, thereby practically "rewriting" or reconstructing an impossible measure whose danger and error had been fully demonstrated. In view of the widespread and reiterated assertion of this opinion, it is deemed necessary, by way of concluding this account of the legislative history of the Federal Reserve Act, to consider with more than usual detail the facts of the con-

ference and to indicate its results. This is called for not merely in order to complete the historical survey of the legislation already offered, but also to dispose if possible of widely diffused and erroneous notions relating to an essential phase of the development of the measure.¹

In studying the outcome of the conference a beginning may be made by briefly reviewing the history of the conference, noting all those paragraphs or sections of the bill in which significant amendments had been made by the Senate and the outcome as it affected them.

House Debate on Conference

When it was announced in the House on December 20 that the bill had passed the Senate with amendments, that a conference was requested and nine conferees appointed by the Senate, discussion first arose as to the number of conferees which the House was to appoint and as to whether or not instructions should be given to them. Mr. Glass asked for unanimous consent that the House disagree with the Senate amendments and agree to a conference. This was objected to for the reason that some of the members regarded the Senate amendments as preferable and desired to make sure that the House conferees should not undertake simply to defeat the Senate provisions. Mr. Hardwick thought it advisable to send a number of conferees equal to the number that the Senate had appointed, but Mr. Glass objected to so large a number. Upon motion of Mr. Murray to concur in the Senate amend-

¹The facts in the case are of course wholly a matter of documentary record. They are found first of all in the Congressional Record, 64th Congress, 3d Session, in the conference report itself (Report of the Committee of Conference, Dec. 23, 1913, 63d Congress, 2d Session), in Mr. Glass's address to the House when presenting the conference report, and in the comparative print of the bill which sets forth in parallel columns the House, Senate, and conference drafts with typographical devices designed to show the exact scope of the changes made in the wording of the several drafts with portions omitted or inserted as the case may be. This latter document is of course final and official authority while the other sources already mentioned give the facts as presented before Congress after the conclusion of the conference sessions and as thereupon acted on in the final adoption of the measure. The text of the present chapter aims to do nothing more than to give a brief and condensed account of the data thus referred to, and verification from the authentic sources herein mentioned is of course easy.

ment, there followed a short discussion in which Mr Glass pointed briefly to the changes in the Senate and their disastrous effect if they should be accepted, Mr Murray urging on the other hand what he considered the improvement made as regards agricultural paper and farm loans. The motion was lost. After a conference had been agreed to, Mr Mann offered a motion instructing the managers on the part of the House to agree to the Senate bill with an amendment as follows: "Strike out all of the Senate amendment and insert in lieu thereof the following"—the "following" being the Hitchcock substitute. This motion was not agreed to. However, a substitute was accepted, introduced by Mr Lever, instructing the conferees to agree to the provision of a Senate amendment extending the time on loans secured by agricultural products and on loans based on farm lands.

The chair thereupon announced as conferees Messrs Glass, Korbly, and Hayes.

Conference Report

The Glass bill was reported back by the committee to the House on the 22nd of December, and in opening debate upon it Mr Glass gave a sketch of the changes which the bill had undergone in conference.

The elimination by the Senate of the Secretary of Agriculture and the Comptroller of the Currency from the Organization Committee and the substitution of two members of the Federal Reserve Board were regarded by the House conferees as impracticable and the old House provision again restored, leaving the organization of the system in the hands of the Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency.

The elimination from the Board of the Secretary of Agriculture was agreed to, but not so the proposition to eliminate also the Comptroller of the Currency, whom the House conferees thought by virtue of his official duty peculiarly well

suted for membership on the Board The terms of office were to be 10 years instead of 6, as originally provided for in the House bill and the salaries were to be \$12,000 instead of \$10,000

As to the number of reserve banks, the House conferees yielded to the Senate, making the number not over 12

The Senate provision decreasing the subscription to the stock of the reserve banks from 20 to 6 per cent of capital and surplus of member banks was agreed to

The changes as to the division of earnings were accepted as far as they concerned the increase of the dividend to members from 5 to 6 per cent and an increase in the surplus fund from 20 to 40 per cent The insurance fund provision of the Senate, however, was rejected "as being a mere pretense of a deposit guaranty"

The view of the House conferees was, that when we have, if ever we shall have, a deposit guaranty law, the tax should be assessed against the banks, that the banks in that event, should be required to guarantee their own depositors, and that not a dollar of the funds of the United States Government should be applied to that purpose¹

As regards the powers of the Reserve Board, the House conferees insisted upon a restoration of the requirement that at least 5 members of the Board concur in any resolution to order rediscounting to occur between reserve banks

The provisions of the Senate extending the time limit of certain agricultural paper were accepted in accordance with the previous instructions by the House

The House conferees yielded to the plan of increasing the reserves from 33 1/3 to 40 per cent, but modified the reserve requirements for individual banks, so that, while they were somewhat less exacting than in the House bill, they were much more so than they were in the Senate amendment

The bond refunding provision, which had been radically

¹ Record, Vol 51, Pt XVII, p 562 (Appendix)

altered by the Senate, was somewhat modified, to make probable the retirement of at least \$300,000,000 of the bond-secured currency within a period of twenty years and the possible retirement of \$500,000,000, based upon a gold reserve and commercial assets, expanding and contracting automatically with the business requirements of the country .

The House bill, which had provided that exchanges should be made at par and charges for collection not exceed the actual cost, had been modified by the Senate, so as to leave it solely within the discretion of the Federal Reserve Board, to fix the charges to be collected by member banks . While the House conferees did not succeed in entirely restoring the provision as it left the House, they largely restored the old language, improving the amendment made by the Senate in essential respects

The House conferees yielded as to government deposits . They accepted the Senate provision making it optional with the Secretary of the Treasury to deposit the government funds in the reserve banks . Said Mr Glass

It is scarcely thinkable that we shall ever have a Secretary of the Treasury who would not so exercise the discretion conferred upon him by the bill, as now reported, as to carry out the real purpose which the House had in view when it made this provision mandatory *

Mr. Glass's View

In concluding, Mr Glass gave a brief summary of the changes, which is herewith quoted in full

1 The House conferees restored the Secretary of Agriculture and Comptroller of the Currency to the organization committee

2 The House conferees restored the Comptroller of the Currency to the Federal Reserve Board, giving the President power to appoint 5 members with 10-years term instead of 6 with 6-years term

3 The House conferees struck out the provision from the Senate Bill authorizing domestic acceptances

* *Ibid* , p 563

4 The House conferees threw out the so-called "insurance of deposit" provision

5 The House conferees threw out the Senate provision permitting Federal reserve notes to be used as reserves in the individual banks

6 The House inserted a provision requiring that the net earnings going to the Government should be applied to the gold redemption fund or to the reduction of the bonded indebtedness of the United States

7 The House inserted a provision requiring that branch banks shall be operated by a board of seven directors, having the same qualifications as directors of the Federal reserve banks, four to be appointed by the parent bank and three by the Federal Reserve Board

8 The House altered the Senate reserve features so as to extend the transition period from two to three years, as was provided in the House bill

9 The House so altered the Senate reserve provision as to require that at least one-third of the reserves of country banks should be held in the vaults of the local banks, whereas the Senate provision permitted all the reserves to be held in the vaults of the reserve bank

10 The House conferees practically restored the collection at par of checks and exchanges

11 A new section on bank examinations was written, omitting some of the objectionable provisions put in by the Senate

12 The House conferees so amended the Senate bond provision as to require the retirement over a period of 20 years of about \$300,000,000 of the bond-secured national-bank notes whereas the Senate amendment did not provide for the retirement of more than \$125,000,000

13 The House conferees threw out the provision prohibiting directors of the Federal reserve banks, class B, from being stockholders of any bank, and practically restored the House provision requiring directors of this class to be selected from a list supplied by the member banks

14 The House conferees practically restored the House restrictions in the matter of requiring one Federal reserve bank to rediscount for another Federal reserve bank

15 The House conferees limited the denominations of the notes to be issued to \$5 minimum, striking out the \$1 and \$2 provision of the Senate, which, it was contended, would cause inflation

16 The Senate provision fixing the number of banks at not less

than 8 or more than 12 stands, as against the House provision making the number not less than 12

17 There was a compromise on the minimum capital, the Senate bill requiring \$3,000,000 and the House bill \$5,000,000 The capital was finally fixed at \$4,000,000

18 The Senate provision striking the Secretary of Agriculture off the Federal Reserve Board stands

19 The Senate method of balloting for directors was retained

20 The Senate increase of gold reserve behind the note issues to 40 per cent, with a graduated tax for falling below that amount, stands

21 The method of raising the capital of the Federal reserve banks on capital and surplus of member banks instead of on capital alone was retained in the Senate amendment

22 The Senate increase of salaries of members of the Federal Reserve Board from \$10,000 to \$12,000 is retained, as is the alteration in the term of service from 6 to 10 years

23 There were several hundred alterations of the text of the Senate amendment

Mr Glass pointed out that there were a number of minor alterations in the text of the House bill, but none in its essential features "But, in the last analysis," said he, "the measure here presented as the conference report upon the disagreeing votes of the two houses is in all fundamental respects the House currency bill"⁴

Opposition of Republicans

When Mr Hayes complained of the method of procedure in the conference, alleging that the minority conferees on the part of the House and on the part of the Senate were not called to share in the conference until the final moment, when it was moved to report the bill, Mr Glass pointed to the fact that the minority conferees were repeatedly and "almost appealingly" invited to offer any suggestion or amendment they might have in mind Mr Hayes's dissenting attitude towards the bill had not changed He could not agree

⁴ *Ibid*, p 564

with his colleagues who regarded the provision on farm loans, now incorporated in the bill, as effective. Only a small percentage of the capital stock of the smaller banks in the country could be loaned to farmers. "No commercial bank of any kind will do this, so it will prove to be nothing but a gold brick thrown for political reasons to the agriculturists of the United States to make them think that there is something in this bill that will take care of their interest."⁵ The one provision—Section 7—which would have benefited the agricultural interests of the country, was struck out. National banks could have established savings departments which would have made available many millions of dollars to the farmer. The new refunding provision, throwing upon the reserve banks the sole burden of refunding the 2 per cent government bonds, was also, in Mr. Hayes's view, against the purpose of the law, which was to make liquid and consolidate the reserves of the country. Another fundamental error, in his opinion, was the elimination of the provision that not more than two members of the Reserve Board should belong to one political party.

Again and again the familiar objections of former months were expressed by a number of other minority members, while majority representatives on the other hand expressed confidence that the measure would have a most beneficial result upon the business of the country. Eventually, however, the conference report was agreed to by a vote of 298 yeas against 60 nays, with 6 members not voting.

Conference Report in Senate

The victories won by the House conferees were considered defeat in the Senate. Indeed, the conviction was expressed by several Senators that the conferees named by the other body, by their successful insistence upon their own ideas, had become the ultimate authors of the new legislation. It seemed to hurt the Senate most that the deposit insurance fund provision had

⁵ *Ibid.*, p. 1442.

been stricken out Messrs Reed and Shafroth defended their position by explaining that this was practically a "last ditch" position on the part of the Senate conferees, and that otherwise the discussion would have come to a point where disagreement would have been reported and the passage of the entire measure delayed

The real point at issue, however, was the method of procedure followed in the conference The minority members in the Senate as in the House complained of the partisan way of dealing with the matter Mr Owen, however, after giving a detailed account of all the happenings before and at the conference, pointed to the ample opportunity afforded to the minority conferees to express themselves The latter none the less felt offended because they had not been taken into consultation in the preliminary work Mr Owen concluded

However we may argue this matter and indulge in rhetoric and in suggestions for and against across the aisle, I think it at last comes down to the question that under our present form of Government, where we are moving under party organization, there is no escape from party responsibility and the plain common-sense duty of the party to act through its organization in the management of matters for which the party feels a party responsibility *

Of all the many prophecies and predictions of the outcome then indulged in, Mr Williams' remark was possibly most to the point

If this is a good bill, a sound bill, and will accrue to the prosperity of this country, the country will stand up and call us blessed If we have made a mistake, the country will rise up and call us accursed That is all there is to it †

The conference report was agreed to in the Senate with 43 yeas against 25 nays and 27 not voting

It is possible to summarize the chief conference changes

* *Ibid.*, p 1487

† *Ibid.*, p 1476

briefly in condensed form somewhat as follows,⁸ and thus perhaps to make them more easily comprehensible

(1) Introduction of provision for sale of stock in federal reserve banks to the public in the event that not enough banks subscribed for the stock to furnish an adequate capital in any given district

(2) Provision for alternative voting in the choice of directors of federal reserve banks so as to insure prompt election

(3) Reduction of number of federal reserve banks to not more than 12, as against the "at least 12" of the House bill

(4) Elimination of requirement that all national banks recharter

(5) Broadening of powers of Federal Reserve Board and modification of language relating to rediscounts between federal reserve banks, so as to render such rediscounts easier than was intended by the House bill

(6) Provision that the Secretary of the Treasury might, not must, deposit public funds in reserve banks

(7) Reduction of reserve requirements placed upon member banks under House bill

On the other hand, the following important points were yielded by the Senate in the conference

(1) Omission of provision that holders of stock sold to private individuals (if any) should have voting power in directorates of federal reserve banks and elsewhere

(2) Elimination of guarantee of bank deposits, by use of surplus earnings

(3) Elimination of provision that federal reserve bank notes might be counted in reserves of stockholding banks

(4) Restoration of provision that many classes of checks should be collected at par throughout the country, and that where such par collection was not enforced the charge for making collection should be fixed by the Federal Reserve Board

(5) Elimination of domestic acceptances, thereby excluding them from use by stockholding banks and from rediscount by federal reserve banks

(6) Modification of reserve requirements as formulated by the Senate so as to require actual cash reserves in the vaults of country banks (the Senate having entirely dispensed with such reserves after twenty-four months from date of the passage of the act) and general

⁸ *American Banking*, 1916, "The Federal Reserve Act," by H. Parker Willis, p. 248

stiffening of reserve requirements made by the Senate, although the final language still constituted a reduction below the House provision

(7) Reduction of period of maturity for which discountable paper might run

While many other points of modification and concessions on either side might, of course, be enumerated, it is believed that the foregoing presentation is representative and shows sufficiently well the nature of the conference work and the character of the points conceded on either side. Assuming that such a fair or representative selection has been made, it is evident that the work of the conference resulted in the establishment of the House contentions at nearly every essential point, the exceptions to such a remark being found in two main particulars

(1) The reduction in the number of reserve banks and their limitation to not more than 12 at any time

(2) The provision that public deposits might or might not be made in the reserve banks at the discretion of the Secretary of the Treasury

Signing the Act

Final action of the Senate and House on the conference report left only the signing of the measure to complete the legislation and make it a law. President Wilson actually affixed his signature late on the 23rd of December, the measure taking effect immediately, although its terms could go into actual operation only after the lapse of months had permitted the processes of organization provided for in the terms of the measure to be carried through to completion. It was with peculiar gratification that the President signed the new measure, recognizing as he undoubtedly did that the adoption of the measure in the form that had been given to it by the House—substantially the form that it had assumed during the period of discussion which had preceded its introduction—was a personal triumph for himself. He did not, however, fail to give due recognition to the conspicuous service that had been rendered by Chairman Glass, addressing to him the letter quoted at another point (page 535). Secretary McAdoo also, whose relation to the legislation had been so checkered, paid generous

homage to the work of Mr Glass, and the recognition of public service which has been granted by the head of the nation was only the beginning of a general burst of applause which became national in its scope. Many who had opposed the legislation from start to finish and had done their utmost to defeat it now found that it embodied beneficial principles and was in the main heartily to be commended. Letters and telegrams in great numbers flowed in upon Chairman Glass and their language was without exception laudatory and complimentary in the highest degree. If the congratulatory expressions were to be taken as worth even a small fraction of their face value it would have been fair to conclude that the financial community as a whole was not merely pleased, but overjoyed at the adoption of the long-contested enactment. But the proof of the pudding was to be found in the eating.

CHAPTER XXII

THE FEDERAL RESERVE ACT—RETROSPECT AND PROSPECT

Certain Questions to be Answered

The passage of a number of years since the adoption of the Federal Reserve Act has undoubtedly raised certain questions in many minds, and at recurring intervals Who was responsible for the act? Was this measure a success? Did President Wilson do right in demanding and insisting upon the adoption of the law which had proved itself so repugnant to the community as a whole and whose support was found only sporadically? The answer to these questions has been variously given and various answers can be found in the writings of given individuals Public men, and even the rank and file of publicists, are prone to change their opinions as conditions change and to be greatly influenced by success During the first two years of the working of the Federal Reserve Law it received but little recognition, although, as will later appear, it probably grew slowly in public approbation During the years after the entry of the United States into the European war and during the period of financial disturbances which ensued upon the close of the war, the great service of the reserve system was unquestioned, and a fulsome type of adulation was substituted by many for the bitter partisan criticism they had offered in the first instance Still later, the measure entered upon an era of complaint and attack through which it is still passing. It is probably fair to say that there has been thus far no general, well-considered, or practically universal, verdict as to the success or failure of the Federal

Reserve Act Mythical statements about the origin and source of the measure have been common, and but little careful study has been given to it even among those who have professed to be most concerned with the sound development of our banking system

Net Result of Measure

It is therefore worth while in concluding the foregoing review of the history and origin of the measure to consider briefly and in summary form the net outcome of the legislation and the extent to which it might fairly be regarded as the successful termination of a controversy which had then lasted in active form for about two decades Reviewing the history of the law, and comparing the various early drafts of the measure with the form which it finally assumed, the following conclusions seem to be fully warranted, and are considered defensible on the strength of the data which have already been assembled and presented to the reader

1 The Federal Reserve Act was finally adopted in substantially the general form in which it had been originally introduced Changes had been of relatively minor character, and in no case had they altered the essential structure or plan of the bill, as first drafted for the House Committee

2 As thus adopted, the Federal Reserve Act embodied the most valuable and useful ideas which had been worked out during the currency and banking discussion subsequent to 1893 Prominent among these were the notions of concentration of reserves, issue of notes upon the basis of business paper, refunding of United States circulation bonds, and establishment of mutual supervision by the banks of the country To these it added new ideas not previously developed, including the "regional" idea, the gold settlement system, and others

3 The act, on the other hand, contained at least nominal concessions to some of the unsound or unwise ideas which had taken root in American banking politics during the same

period Among these are to be mentioned the notion of bank notes as a government currency, the power on the part of the government to intervene continuously and steadily in the operation of banking, and to shape discount rates for class reasons, as well as the general effort to establish a still further and more elaborate red-tape control over banking These objectionable features had been kept no doubt to a minimum and had, too, in many ways been robbed of their most dangerous qualities Nevertheless they were present and, as time was to show, were certain to produce the unfavorable results to which their inherent nature had to give rise

Conclusions as to Origin

The study of the final product embodied in the Federal Reserve Act in comparison with other measures also leads undoubtedly to the following conclusions

- 1 The Federal Reserve Act was not a copy or derivative of any other single bill

- 2 It had little or no relationship in principle to the so-called Aldrich bill, although it in various places made use of the language of the Aldrich bill on matters relating to banking technique

- 3 It was not derived from, or modeled after, or influenced even in the most remote way by other bills or proposals currently put forward from private sources, but, on the contrary, it was itself the pattern from which a host of imitators sought to copy

- 4 It was not an "original proposal" in the sense that it embodied anything new in regard to banking principle, but, on the contrary, it was the digested product of elaborate and careful study of European banking experience as adapted to American necessities and requirements

- 5 It was a measure which undoubtedly held out to the various banks great opportunities of new profit, since they were relieved of unduly burdensome reserve requirements and were

in many ways protected against costly and difficult necessities growing out of recurring stringency or business difficulty

6 It offered a great protection to the public by insuring against banking suspension and by tending to "smooth out," and unify, rates of discount the country over, and it was particularly a safeguard to the interests of the agricultural population, since it insured them abundant access to credit for marketing under conditions which were certainly reasonable

7 In addition to these qualities the Federal Reserve Act also provided a very great and much needed reform in the conduct of the government's fiscal affairs and furnished a means whereby the unnecessarily expensive and disturbing Treasury system could be ended

Authorship of the Act

The question of the authorship of the Federal Reserve Act has been many times referred to during the eight years which have passed since its adoption, and it has already become the center of a multitude of erroneous statements. The authorship of any large piece of work which has engaged the attention, first and last, of many minds is always open to some doubt and differences of opinion. It is, moreover, usually a matter about which controversy is ungraceful and should, if possible, be avoided. In the case of the Federal Reserve Act, the issue has a more than ordinary importance because of the fact that the real authorship has been variously ascribed to members of the so-called "Money Trust," and by virulent anti-Semites like Mr. Henry Ford to international groups of "Hebrew bankers." On the other hand, the authorship of the measure has been ascribed in Congress to various individuals who represented definite political tendencies or sections of opinion. It is unquestionably in the interest of historical accuracy that a careful statement of the facts in the case should be made, with a view to placing on record as definitely as possible the circumstances under which the measure originated.

In preceding chapters pains have been taken to trace the history of the Federal Reserve Act from its initiation to its adoption, and it should be plain from the facts and data there given what were the several steps by which the measure was developed. The purpose of the present survey, therefore, is merely to draw together some conclusions founded upon the general body of detail already supplied and specifically to meet certain assertions which have been made in various quarters concerning the measure.

In the study of every piece of legislation, which is the outgrowth of a long period of discussion, "authorship" must be considered from two standpoints—that of the indirect sources or origins of data, and that of the direct or immediate sources. We may take these two phases of the situation in their order.

Mode of Preparing the Bill

In a foregoing chapter, it has been seen that the preparation of the Federal Reserve Act was carried out through a comparison and careful analysis of a considerable number of preceding bills or drafts which had become common property during the twenty years preceding its preparation, and that further elements in it had been derived from a study of foreign banking legislation. The basic elements or ideas which may thus be said to have been common for many years past to nearly all measures that dealt with the subject at all may be enumerated in skeleton form about as follows:

1. Retirement of bond-secured national bank currency and substitution of an issue corresponding in volume to business requirements
2. Joint or co-operative association of the banks of the country in some type of organization through which common action could be obtained
3. Rediscounting of paper by this common or joint organization for its members.

- 4 Issue of notes by the association in favor either of the public or of its member banks, or both.
- 5 Joint inspection or examination of members by the central organization
6. Holding of government funds and probable performance of duties as fiscal agent to some extent by the central organization
- 7 Participation in or leadership of a home discount market

As has been stated, practically all of these features were found in the principal currency reform or banking reform bills of the two decades prior to 1912. Substantially all of them appeared in the so-called Aldrich bill which was the immediate predecessor of the Federal Reserve Act. All of them appear in one form or another in the Federal Reserve Act. In so far as the "authorship" of these facts or ideas was derived from earlier bills, it may therefore fairly be said that the Federal Reserve Act "drew upon" these earlier measures. It did not draw upon any one of them more specifically than upon any other for its general features, but it drew upon a common stock of ideas upon which the authors of previous bills had themselves drawn and to which they contributed in their work.

Relation to Aldrich Bill

Least of all did the Federal Reserve Act draw upon the Aldrich bill for its broader concept¹. It has been remarked at various places throughout the preceding chapters, and may be emphasized at this point, that the underlying thoughts of the Aldrich bill were in many respects out of harmony with those immediately preceding measures of legislation, and that the Glass bill or Federal Reserve Act was a reversion to the more direct line of descent from the earlier measures that had preceded the Aldrich bill. This, however, did not prevent the use

¹ Former Senator Hansbrough, in a letter to the *New York Times*, published August 18, 1920, gave a critique of the Federal Reserve Act. The letter is reproduced as Appendix A to this chapter.

of such features of the Aldrich bill as were considered to be desirable or even in various places the use of language drawn from or modeled after the language implied in the Aldrich bill. Whenever it was felt that such language could be used to advantage, that use was made of it, because of the fact that the Aldrich bill had enlisted the careful attention and thought of many preceding students who had labored upon it and had here and there produced expressions or phrases which seemed well adapted to their purposes. At times it was necessary to insert a "not" before some provision of the Aldrich bill which had been taken over, or otherwise to introduce a prohibition rather than a permission with reference to some banking function, due to a difference in point of view as between those who were interested in the Federal Reserve Act and those who had framed the Aldrich bill. The Aldrich bill in many particulars indicated what was sought or desired by interests which were considered inimical to the public welfare and it was a very substantial service in the framing of the Federal Reserve Act because it showed what was to be guarded against in sundry important particulars. Perhaps this was the most effective way in which the Aldrich bill was "used" or "drawn upon" in the framing of the Federal Reserve Act.

Use of Technical Provisions

There was another reason for the use of Aldrich bill language at certain points. It had been recognized from the beginning that one of the familiar arguments used by some figures in the banking world for the purpose of discrediting or attacking given bills was to stigmatize them as "amateurish." This amateurishness was usually regarded as applying in matters of important detail or technique. By using language which had been itself employed or vouched for by this banking group the charge of amateurishness was largely nullified or offset—a condition which proved of very material assistance at various stages in the course of the development of the Federal

Reserve Act Legislators or administrators who had been frightened by statements that provisions in the Federal Reserve Act were "dangerous," "loosely drawn," the work of "news-paper men," and by other methods of the same sort, were greatly reassured when shown that, so far as technique was concerned, a nice regard had been paid to the provisions of the Aldrich bill, which itself was regarded by bankers as the best product which they and their expert staff could turn out This probably furnishes a sufficient review of the general attitude adopted toward the Aldrich bill by the framers of the Federal Reserve Act It is worth while, however, to enumerate in detailed form the principal particulars in which the Aldrich bill essentially differed from the Federal Reserve Act, and from other plans of the same general description.

Differences of Principle

1 The Aldrich bill was fundamentally based upon German experience, while the Federal Reserve Act was based upon British experience primarily and upon the experience of the British colonies

2 The Federal Reserve Act adhered to the American practice of refusing a position in our reserves to the note currency and of assigning that function entirely to deposit credits with the central reserve institution The Aldrich bill followed the opposite plan

3 The Federal Reserve Act endeavored to give to the constituent member banks a democratic kind of self-government, while the Aldrich bill provided for control in proportion to capital

4 The Federal Reserve Act ended the old reserve city deposit system with its "pyramided" reserves The Aldrich bill would have retained it save in so far as it might be voluntarily abandoned

5 The Federal Reserve Act in its eventual form placed the central or head office function of the system in the hands of a

Board of presidentially appointed officers, while the Aldrich bill, although giving a voice to the government, retained the essential control in the hands of the bank

6 The Federal Reserve Act located a self-governing head office in each of the 12 districts into which the country was divided, while the Aldrich bill placed a branch in each of the 15 districts which it recognized, and established over them a central banking institution

7 The Federal Reserve Act followed a distinct plan of its own in connection with clearances and collections, while the Aldrich measure simply called for the general exercise of clearing functions by the central reserve bank in such way as might presumably be established by its management

Much detail might be afforded concerning the numerous differences between the two measures, but all that is sought here is to clear up the general question how far in spirit and purpose the one measure was a duplicate of the other. Broadly speaking, it may be stated that no such duplication existed—bearing in mind what has already been said of the use made of the Aldrich bill in connection with the process of drafting

Relation to Fowler Bill

The statement has from time to time been made that the Federal Reserve Act was a duplicate of the Fowler bill of 1910 and Mr Fowler himself, although a very severe critic of the Federal Reserve Act, has had this to say

The first draft of the Federal Reserve Act was made by Mr Fowler who introduced the bill on March 29, 1910, and made an extended speech on the measure .³

At an earlier point in the present volume extensive comparison has been made between the Fowler bill, the Muhleman measure, and the Aldrich bill and it would seem that no repetition of this analysis need be made at this point. About

³ Charles N. Fowler, "The U. S. Reserve Bank, the Fundamental Defects of the Federal Reserve System and the Necessary Remedy," Hamilton Book Co., Washington, D. C., January 1, 1922

the same may be said with reference to the Fowler measure in a general way that has just been said with reference to the Aldrich bill, except that, as already stated, the Federal Reserve Act may be regarded as much more nearly a lineal descendant of the Fowler bill and other measures than of the Aldrich bill. On the other hand the Fowler bill lacked, as did many of the earlier measures of its author, in technique and care of detail and it therefore provided no specific provisions which, it was felt, could with advantage be used in the drafting of the Federal Reserve Act.

Work of P M Warburg

Many writers and speakers have ascribed the drafting of the Federal Reserve Act largely or wholly to Mr Paul M Warburg, then a member of the banking house of Kuhn, Loeb and Company and subsequently a member of the Federal Reserve Board. So far as the present writer knows, Mr Warburg has never made any statement regarding the authorship of the act from any point of view. His relation to it as shown by the documents and events of the time was simply that of a critic, as shown in the foregoing chapters—and a critic whose recommendations were not adopted.³

Senator Owen's Work

Senator R L Owen, the chairman of the Senate Banking and Currency Committee, has also made various speeches on the same subject. While some have been made on the floor of Congress, the peculiar conditions which surround such utterances may have tended somewhat to color them and it is probable that his more considered views are to be found in

³ Because of the constant misstatements on this topic Mr Glass, on March 30, 1915, wrote a letter to the *New York World* which is reproduced in Appendix B of this chapter as a matter of justice to Mr Warburg and all concerned. What Mr Warburg thought is shown by a letter he wrote to Chairman Glass, likewise reproduced in Appendix B, which is of some interest also for the forecasts it contains. Cf. also ante pp 431 and 432 for Mr Warburg's earlier views. Mr Warburg's view of his own work was perhaps best given in his "hearing" before the Senate Banking Committee, August 1, 1914, confidentially printed.

his regularly published writings. Turning to this source for information, the following statement is to be found ⁴

During the preceding winter (1912-13) Hon Carter Glass, Chairman of the Committee on Banking and Currency of the House of Representatives had made a preliminary draft which he had submitted to President-elect Wilson. I was advised that this draft had met with the tentative approval of the President. Mr Glass gave me a copy of this draft and his notes thereon which I have preserved. I too made a draft incorporating the principles I had advanced in 1908 and these two proposals became the basis of discussion in framing the Federal Reserve Bill which finally became the Federal Reserve Act.

As to this perhaps the only comment that is necessary is to refer the reader back to Chapter XII of the present volume in which the history of Senator Owen's participation in the preparation of the act is given in detail as an element in the history of the Glass bill. The Owen bill (issued after the Federal Reserve Act had been placed in Mr Owen's hands)⁵ is printed in the present volume as Appendix VII. The subsequent history of Senator Owen's relation to the measure, as the reader is aware, will be found in the foregoing pages at various points.

Contributions of Colonel House

Various statements from time to time have been put forward concerning the active participation of President Wilson and of Colonel House in connection with the preparation of the Federal Reserve Act. In an earlier chapter it was shown that the Glass bill had been drafted before President Wilson took office, and that the preliminary draft was shown to him on December 26, 1912, a final draft being presented to him at Trenton toward the end of the following February, the measure being indorsed by him as thus finally shaped under the leadership of Chairman Glass. President Wilson's serv-

⁴ Robert L. Owen, *The Federal Reserve Act* (1919), p. 74.

⁵ See Chapter XII.

ice to the country, important and absolutely fundamental as it was, had nothing to do with the development of any essential features of the measure and his most important effect upon its content was seen in the change made for the purpose of satisfying the Bryan element in the administration and in Congress. This statement in no wise underestimates the importance of President Wilson's service in connection with the adoption of the law—indeed it could never have become an act without his steady, persistent, and insistent support of it. It is merely a statement that his service did not consist in originating the ideas of the measure but in securing their adoption. As for Colonel House his only relation to the bill was found in the various sporadic efforts made by him to focus criticism upon it.⁶

The Citizens' League

The National Citizens' League or its officers have at various times been spoken of as originating the Glass bill

⁶ A different view, however, is given in the authorized biography of Colonel House, "The Real Colonel House," by Arthur D. Howden Smith, where it is stated that the welfare and content of the Federal Reserve Act was constantly upon his mind. Colonel House was in Europe during the time that the act was passing through its most critical stages, while, as already seen, the measure had been fully drafted before the Wilson administration came into power. Mr. Smith says on page 142:

"Now, the Currency Reform bill was the project of the Administration in which Colonel House took deepest interest. He was not a banker, you will remember. But for many years he had been studying financial conditions in the United States, and he had come to the conclusion long before this that there was something radically wrong with existing institutions. He had noted the liability of the country at intervals to blind, causeless panics, starting in sudden bursts of unreasoning fear, which swept all before them. He had noted the absence of any concrete financial machinery to be put into use to meet such emergencies. He had noted the unbalanced distribution of banking power and the tendency of the country as a whole to lean on the authority of the group of big bankers in the Eastern cities, with the inevitable result of placing in the hands of these men practically unlimited power for good or ill."

On page 143 Mr. Smith says:

"When Congress met Colonel House went to Washington and held a conference with Representative Carter Glass, of Virginia, who was to have charge of the projected bill in the House, Senator Owen, of Oklahoma, its sponsor in the Senate, and Secretary McAdoo. These three men went at the problems presented by the bill in very different ways, and each produced suggestions of great value. But none of them contributed more to it as finally enacted than did the President. Indeed, without the President's keen brain and helping hand, the measure might well have failed, or at least, gone through in feeble form. Never was Mr. Wilson's genius for leadership more clearly demonstrated. Colonel House's part in the transaction was, as customary with him, that of bringing opposing views into line, preventing disagreements, and interpreting advice and criticisms from all classes of men and all parts of the country."

An imaginative account of President Wilson's relation to the measure is also given in J. P. Tumulty's "Woodrow Wilson as I Know Him" (pp. 174-5). Mr. Tumulty places the conference on the bill on "one of the hottest days in June." It, however, occurred, as above noted, in December.

and again as having supported or indorsed the Aldrich bill. Exactly how far the League had officially committed itself to the Aldrich bill has never been established. There was a prevailing opinion that the leaders in the organization were quite definite in their support of that measure, and report had it that they had so instructed their subordinates. Whether this be true or not it is undoubtedly a fact that during 1912 some elements in the organization had become disposed to give up the effort to obtain the original form of the Aldrich bill, provided that something more or less satisfactory to them could be substituted for it. When the Glass sub-committee was first reported as having the question of banking reform under consideration Professor J. Laurence Laughlin, then chairman of the executive committee of the Citizens' League, wrote proposing that he be allowed to furnish the committee with a bill presumably on behalf of his organization. Conditional upon the acceptance of this bill he thought it probable that he could obtain the support of the Citizens' League and of the American Bankers Association for the plan. In a letter which was written on December 24, 1912, he said in part

What I am trying to do is to get general agreement on a bill Glass can approve. If Glass's committee could come up to something like this measure . . . I am sure we could put behind it the support of the League, the American Bankers Association, and the National Chamber of Commerce. Is it not well for Glass to welcome such support?⁷

This bill when received by Mr. Glass was filed with the numerous other bills which had been transmitted to the Committee and received the same consideration that was accorded to all measures so presented. Neither Mr. Glass nor the Committee ever considered the idea of accepting this or any other bill presented by an outside interest as the basis of their work.

⁷ The Glass bill, as seen in the foregoing chapters, received the support of none of these organizations.

and none such was ever used in that way. The bill in question has never been published as submitted to the Committee. It was succeeded by various drafts constituting a series of proposals which came to the Committee from time to time and were filed as in the case of all others. There was thus at no time any one accredited bill before the Committee representing the views either of Professor Laughlin or of the Citizens' League. The original Citizens' League bill, filed with the Committee by Professor Laughlin, as just explained, was prepared after conference with Mr. Glass in which the latter in response to questions had stated, as he did to every other authorized inquirer,⁸ the main outlines of the scheme upon which the Committee's expert was working, and the bill as originally filed apparently was intended to put the views of the Citizens' League into a frame or shape similar to that tentatively favored by the Committee and thus to obtain a more favorable hearing for them.

Other Contributors

As for the multitude of others whose claims to authorship of the Federal Reserve Act have from time to time been made public very little needs to be said. There are many volumes in which there appears in the preface language to this effect: "The author had a share in the preparation of the Federal Reserve Act and did what he could to secure the adoption of that measure." In all such cases, so far as the present writer is advised, the statements thus made are without known or recognized foundation, and while it is doubtless true that those who have put them forward may have been consulted by some one of the legislators at work upon the Federal Re-

⁸ Professor Laughlin wrote on December 16, 1912: "My whole idea is this after seeing him (Mr. Glass) last month, I went home to try to work out a plan along his ideas." In reply, Professor Laughlin was advised that "whatever bill may be reported will be the result of his (Mr. Glass's) own work and analysis. He is, however, anxious to get all possible sidelights on the situation and will undoubtedly study your plan attentively along with the others now in his hands."

serve Act, or may in some other indirect way have been warranted in the statements made, it is a fact borne out by the records of the House Banking and Currency Committee, fully placed at the disposal of the present author, that no indication or trace of the work done by these soi-disant counselors is to be found there. The truth of the matter is that the consultations and assistance that were obtained in the preparation of the Federal Reserve Act were of an impersonal description, the data needed being drawn from published sources, existing bills, hearings, and other available matter. In so far as there was any known departure from these methods, the facts have been stated from time to time in the foregoing pages. The act itself owed such merit as it had to the circumstance that as many of such sources as possible were consulted and effort made to use without any partisan spirit the material made available in them. Whatever its faults, it was not open to the charge of having been drawn en bloc from any special interest or of having been furnished by any given group, organization, or individual.

Work of Chairman Glass

Earlier analysis has shown the character and measure of the responsibility to be assigned to the various men who collaborated in the development and adoption of the act. It is worth while, however, to place on record the views of various persons then much in the public eye especially because of the later efforts of various legislators and others to take to themselves a responsibility for what in earlier months they either shirked or opposed.

President Wilson, to whose firm determination to make the Federal Reserve Act a law before the end of the year 1913 was due the fact that it ever became law at all, wrote to Chairman Glass simultaneously with the adoption of the measure as follows

THE WHITE HOUSE
Washington

December 23, 1913

My dear Mr Glass

May I not express my admiration for the way in which you have carried the fight for the currency bill to an extraordinarily successful issue I hope and believe that the whole country appreciates the work you have done at something like its real value and I rejoice that you have so established yourself in its confidence

With sincere admiration,

Cordially yours,
(Signed) WOODROW WILSON

Hon Carter Glass,
House of Representatives

Secretary McAdoo wrote

THE SECRETARY OF THE TREASURY
Washington

January 12, 1914

My dear Glass -

Now that the Federal Reserve Act is law I write again to congratulate you on the splendid and effective part you had in the formulation, construction and passage of it I believe no one can speak with greater knowledge and authority of the splendid part you have had in this notable piece of business In the concluding stages of the fight and in the work of the conferees you exhibited in a rare degree those qualities of intelligence and statesmanship which brought the measure to successful fruition You have made for yourself enduring fame, and no one rejoices more in your deserved success nor wishes you a longer life of continued usefulness to your country and to your friends than,

Yours faithfully and sincerely,
(Signed) W G McADOO

Hon Carter Glass,
House of Representatives

Hon A B Hepburn, the chairman of the Currency Commission of the American Bankers Association, wrote

THE CHASE NATIONAL BANK
New York

December 26, 1913

Hon Carter Glass,
House of Representatives,
Washington, D C

My dear Mr Glass

I congratulate you upon the successful issue of a long, hard fight on the currency question. You have from the outset possessed full public confidence, everyone has believed that you were working earnestly and untiringly to accomplish good results. Legislation of this kind is always more or less of a compromise, but it is now legislation, and as law-abiding citizens it is the duty of everyone to do the best he can to make the law a success, helpful and serviceable to the business interests of the country and the citizens generally.

You made a most excellent impression in this city by your speech before the Economic Club, and altogether you have won a very enviable reputation.

Sincerely yours,
(Signed) A BARTON HEPBURN

Value of Federal Reserve Act

Taken in its true aspect as thus set forth, the question whether the Federal Reserve Act was or was not desirable in American banking organization must be answered by reference to its results. From this standpoint, the fact that the measure has maintained itself for eight years without any destructive modification of its principle seems fairly to indicate that it has been regarded as essentially beneficial. Probably the majority of bankers today would admit that the federal reserve system was in principle a permanency, although a large number of them would probably add either mentally or orally that further modifications in it were still desirable. It is, however, clear that, in judging of financial legislation, mere popular verdicts are not always reliable. Indeed, a survey of American banking history seems to indicate that whenever a law or system is popularly received and accepted, there is good ground for thinking that it is open to suspicion. The federal reserve sys-

tem, therefore, must be very carefully judged, not only on the basis of the contents of the act which created it but also from the standpoint which is furnished by a thorough study of the actual working of the law. Such a study and analysis it is proposed to give in subsequent chapters, but at this point it seems necessary to anticipate the later and more detailed analysis by noting some essential elements that were developed in the course of the administration of the law. These should be borne in mind by the student of the legislation who has followed this review of its early history and who has the patience to pursue the subject through the various intricacies of administrative ruling and management.

The Federal Reserve Act was nowhere weaker than in its conspicuously beneficial aspects. Having been framed from a purely independent standpoint, without reference to the various conflicting interests and with but little concession to them, on the whole, the Federal Reserve Act was undoubtedly far in advance of the banking practice or the banking knowledge of the community at the time it became law. It was therefore subject to the danger of misunderstanding and misapplication from which all such laws must suffer. Thus, for example, the attempt to define and put into effect the strict requirements of the legislation with reference to eligible paper was at an early date in the history of the system to be found a matter of the utmost difficulty, not because of the lack of transactions of the kinds contemplated, but simply because of the failure on the part of the rank and file of customers to understand the desirability of compliance with these requirements. So, too, when the rate policy of the federal reserve system came to be subjected to criticism and analysis, it was obvious from the first that there was no general public opinion that could be relied upon to furnish a check or test of the policies inaugurated by the Federal Reserve Board. Being in advance of the prevailing banking opinion and practice, in the United States, the act faced the great danger of being applied in an academic or

idealistic way that would prevent it from rendering its greatest use, or that of being applied by men who had no sympathy with it and who sought to distort its provisions, remoulding them to conform with prevailing banking practice, or securing amendments from Congress designed to permit such changes to occur. The act, in fact, suffered from both these elements of danger, although from neither in the full force and effect that might have been expected. It has not attained the objects which were in the minds of its framers but, on the other hand, it has succeeded in greatly improving banking methods at many points. Since no human institution is ever perfectly successful, it may perhaps be said that the Federal Reserve Act has been a success in the sense that it has not only rendered actual service in a practical way, but has in some measure improved the general position of banking and of banking method in this country.

Failure to Win Support

One final point is worthy of comment in closing this history. The Federal Reserve Act has been a success in the limited sense already indicated above, but it has certainly failed to make for itself a definite place in popular opinion and support. Cut off, as it naturally is, by the terms under which it exists, from direct contact with the borrowing public, it has always been difficult for the system to make plain the true nature of its motives or objects, and to get from the rank and file of the public free and intelligent criticism or a sincere approval and support of its efforts. This is always a very serious handicap for any human institution. Sincere and unbiased criticism is seldom to be had from those who are directly interested in the operation of any financial organization, and can be secured only through the building up of a wide public opinion on the part of the community as a whole. It is not to be denied that there has been a beginning in the

evolution of such an opinion, but that evolution has been slow and there is reason for some question as to the length of time that will be required, should the act continue substantially in its present form, before there can be considered to exist a well-developed and reliable financial sentiment to which appeal can be made on doubtful points

It is this perhaps more than any other factor that has kept the system constantly open to the menace of what is called "politics "

APPENDIX A TO CHAPTER XXII

LETTER FROM FORMER SENATOR HANSBROUGH TO THE NEW YORK TIMES GIVING CREDIT FOR RESERVE ACT

To the Editor of the New York Times

In the interest of truth and as a matter of justice toward a much-maligned Administration, I feel it a duty to give the facts in regard to the movement which led to enactment of the national reserve law

Notwithstanding the antipathy of party-first Republicans to that measure, a leading paper, blindly attached to Mr Harding and reactionary politics, recently said that this beneficent piece of legislation originated with the Aldrich Monetary Commission of 1908-12 Without any desire to take credit to myself, the record will show that the framework of the Monetary Commission's bill was introduced by me in 1907

And I do not forget the attitude of bankers and Republican Senators in regard to it I was laughed at and guyed by my party colleagues, who scouted the idea of "the Government going into the banking business," for this would be the effect of my bill, they declared Moreover, out of fully a thousand letters I received from bankers on the subject, according to my present recollection, only one, written by A. Seligman of New York, commended my course

Senator Aldrich himself, who was Chairman of the Finance Committee, of which I also was a member, was particularly facetious in his allusions to the bill and its fate It would "make good pigeonhole lining," he said to me

To my very great surprise, however, within a year thereafter Mr Aldrich secured authority from Congress and put through an initial appropriation for a monetary commission composed of certain Senators, Representatives and financiers The Commissioners, with

Aldrich as their Chairman, entered upon elaborate plans, traveled in Europe for several months and on their return held extended hearings, with the result that in 1911, I think it was, a bill was brought in for a reserve bank system which was entirely to the liking of the bankers

The measure did not go to the pigeonhole, but to the Senate calendar, where it awaited a favorable opportunity for consideration. It was still inchoate when Mr. Wilson was elected in 1912

Fortunately for this country of panics, the first important step of the Wilson Administration in 1913 was the enactment of the national reserve law, but it is as unlike the Monetary Commission's bill as the latter was unlike my own feeble effort in that direction. Nor was the present law at first to the liking of the bankers, as a class. The reasons for their dislike are obvious. In time, however, also for obvious reasons, quite a number of them gave it sanction.

The historical facts stated above are susceptible of proof by any one who chooses to consult the Senate files. I am prompted in making this statement by the bald inconsistency of the Republicans of today who criticise the law and yet claim credit for it.

No such distortion of issues would have been tolerated by Nelson W. Aldrich, who was a fearless leader. Were he alive he would courageously point out to the molasses-candy candidate of the Republicans that nothing is to be gained by attempting to confuse the real issues.

From my long acquaintance with the late Rhode Island Senator, I have no doubt he would boldly charge the Democrats with responsibility for a law which was not in the interest of "substantial prosperity." And substantial prosperity, in the estimation of my old and greatly admired colleague, was not to be attained if it could not come through the banks, by the banks and for the banks. This was his attitude throughout his long and distinguished career in the Senate. He saw no disaster in policies which openly acknowledged the superior rights of capital as a first consideration. It was not his habit to wait until after election to show his hand.

With Aldrich as the leader of the Senate there would be no "Lodge reservations" to confuse the public mind in the hope of getting votes. Whatever suited the kind of prosperity he believed in, he would be for it, with malice toward none and without a qualm.

In other words, Aldrich would be against the existing national reserve law and the League of Nations, but his opposition would be devoid of hypocrisy.

HENRY C. HANSBROUGH.

Lakeville, Conn., Aug. 14, 1920

APPENDIX B TO CHAPTER XXII

CHAIRMAN GLASS'S LETTER TO NEW YORK WORLD*

Lynchburg, Va., March 30, 1915.

To the Editor of the World
New York

Sir

I am altogether disposed to concur in your estimate of Mr Paul M Warburg as "the ablest scientific banker in the United States" For this reason I was among those who first urged the President to make Mr Warburg a member of the Federal Reserve Board

I also concur generally in the statement of facts contained in your leading editorial of March 27th and the deductions therefrom Hence I think it is a pity that you should have marred the conclusiveness of such an excellent article by asserting that Mr Warburg "had more to do with the actual drafting of the Federal Reserve law than any other man, either in Congress or out of Congress" There never was a more flagrant misstatement of fact Mr Warburg did not draft a sentence of the law He was in Europe when the bill was being prepared and wrote an adverse criticism of some features of the measure from abroad

Upon Mr Warburg's return from Europe he was several times brought into conference upon certain major problems urged by him, such as (1) "piping" the twelve regional banks into three central banks, (2) establishing a system of "domestic acceptances" and (3) permitting federal reserve notes to be used as reserve by member-banks If you will examine the statute you will find that not one of these provisions is in it The Senate adopted two of them, but the House threw them out in conference

This utterly erroneous statement in your editorial of Saturday is only comparable to an assertion made some time ago by Mr Harvey in the North American Review to the effect that the House currency bill was "so radically changed by the Senate as to bear little resemblance to the law as enacted" Such a declaration betrays indefensible ignorance It is based upon the fact that the Senate made various changes of phraseology in the House bill and some very radical alterations of its essentials, but had Mr Harvey troubled himself to pursue the course of legislation he would have seen that the House conferees restored every single important feature of the House bill and discarded every fundamental change made by the Senate

* See footnote, page 530

In presenting the conference report to the House I directed attention in detail to the work of the conference committee, showing that the integrity of the House bill had been absolutely preserved in every single fundamental feature, and in the other chamber Senator Owen made a similar statement

Respectfully,
CARTER GLASS

MR WARBURG'S LETTER TO CHAIRMAN GLASS

Kuhn, Loeb & Co
William and Pine Streets,
New York, December 23rd, 1913

Dear Mr Glass

Permit me to congratulate you upon having successfully brought to an end the very onerous task of perfecting the currency law, and steering it through the many cliffs

While my heart bleeds at many things that went into the Bill, and at many things that were left out, I rejoice at the many good features that, after all, the law will contain. There cannot be any doubt but that the perfection of this legislation means a new era in the history of banking in the United States. The fundamental thoughts, for the victory of which some of us have worked for so many years, have won out. That is to say, from now on we shall witness the gradual elimination of the bond secured currency, of scattered reserves, of immobilized commercial paper, and of pyramiding of call loans on the stock exchange. Where we differ it is in most cases a question of degrees. Whether concentration has gone far enough with eight Federal Reserve Banks, whether reserves will be sufficiently consolidated by lodging a portion in the hands of the member banks, and by not permitting the notes to be counted as reserves, whether \$25,000,000 annually is a large enough amount for reducing the inelastic national bank currency, whether ninety or a hundred and eighty days is the right maturity for paper to be rediscounted, all these are questions not of principle, but, as stated, of degree.

As long as this legislation was a question for discussion, it was incumbent upon all of us to offer the freest criticism, and to try to be helpful within the limits of our abilities. Now that, for the time being at least, the discussion is closed, and the law will go into effect, there remains only one thing for us to do, and that is for each of us to do the best he can to give it the fairest and fullest test. If, after

a few years of actual experience, it should be shown that the business community was wrong in its suggestions and in its apprehensions, we shall be satisfied, if it should be shown that we were right, I believe that the country at large and its representatives at Washington will then be perfectly willing to amend the law. By that time a great many things which to-day are questions of theory will have become hard facts, and everybody will be able to judge from actual experience. In this, I am sure, we both feel alike, because from the various talks that it was my privilege of having with you, I am more than confident that, if you could have had things entirely your own way, the law would look differently in many respects. It is only natural that, in a matter where so many minds had to agree, concessions and compromises were necessary, and I suppose we shall have to be satisfied with having been able to make so substantial a step in advance. I sincerely hope, however, that a conservative Federal Reserve Board will see to it that the instrument now created will not be overtaxed. As it has been enacted, the law will provide for an emergency organization, which will be safe, if conservatively managed, and which will, very gradually only, lead toward substantial fluidity of credit by the creation of discount markets.

It is earnestly to be hoped that, if it should prove impossible to reach this latter aim in the immediate future, the future board will not overheat the boilers up to a danger point by trying to make this craft perform duties which now may be beyond its power, but rather, after a fair and conservative test, do the necessary work of perfecting the construction.

Meanwhile you are entitled to the thanks of the Nation for the hard, conscientious and able work that you have done, and personally I want to add my sincere appreciation for having been permitted to counsel with you so frankly and frequently.

With assurances of highest esteem, and with best wishes, I beg to remain,

Yours faithfully,

(Signed) PAUL M. WARBURG

Hon. Carter Glass, Chairman,
The Committee on Banking and Currency,
House of Representatives,
Washington, D. C.

BOOK II

**ORGANIZING THE FEDERAL RESERVE
SYSTEM**

CHAPTER XXIII

PROBLEMS OF ORGANIZATION

Plan of Organization

The Federal Reserve Act had wisely committed to a small body of men the duty of studying and preparing for the organization of the federal reserve system prior to the creation of the Federal Reserve Board. This feature had been included in the measure from the very outset. It was part of the original conception of the system that the mechanism should be turned over to those who were to operate it, as a going concern, or practically that. Experience showed that there were inevitably mistakes in presidential appointments and that men could much more easily be held to responsibility for something that had been entrusted to them than for something which they were called upon to establish or to create.

So, in spite of subtle and persistent opposition, at many points and on various occasions, the provision for an Organization Committee to consist of the Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency had been retained in the bill—a decision whose wisdom, though often doubted and at times doubtful, was amply vindicated by subsequent events. This committee had now to be called into existence.

Secretary McAdoo's Analysis

Secretary of the Treasury McAdoo recognized the seriousness of the duty thus laid upon him. He viewed the problem as consisting of four distinct parts or elements, each more

or less separate from the others (1) the division of the country into banking districts, (2) the organization of the reserve banks in the several districts, (3) the choice and organization of the Federal Reserve Board, and (4) the definite opening and establishment of the banks. Of these four divisions or branches of the work, the first two were distinctly the duties of the Organization Committee, while the third and fourth were at least in large measure organization functions in which two members of the Committee, by virtue of their ex-officio membership of the Board itself, would play a large part. Of these separate elements, the outlining of the district was, of course, the first, while preparation for the organization of the banks themselves was nearly as urgent if the institutions were to be set on foot without delay.

Division of Labor

After due consideration it was determined to take in hand for immediate attention the problem of districting and to turn over to an organization of technical experts the plans for internal bank organization.¹ Using the funds which Congress had provided, it was planned to make an extensive tour of the country for the purpose of taking testimony regarding the proper district division of the country and for the further pur-

¹ Secretary McAdoo accordingly early in January, 1914, appointed the author chairman of this Committee of Financial Experts (the Preliminary Organization Committee so called) and requested him to form the Committee itself. He did so, selecting the following members: Joseph A. Broderick, then a member of the State Banking Department of New York, an authority on bank reporting and examination, O. Howard Wolfe, then Secretary of the Clearing House Committee of the American Bankers Association, a well-known authority on clearing and collections, Edmund D. Fisher, Deputy Comptroller of New York, a well-known expert on commercial and investment paper and trust company operations, Ralph Dawson, of the Guaranty Trust Company of New York, a skilled foreign exchange expert, Andrew H. Benton, of the firm of Marwick, Mitchell, Peat and Company, accountants, was also a member.

With these were later associated Messrs. Harry E. Ward and C. C. Robinson of the Irving National Bank, who collaborated in the development of an accounting system. The result of the Committee's work was a report which was later distributed as a confidential document to all directors of reserve banks, and became, as will be seen, the basis of reserve bank organization.

Secretary McAdoo assigned to the author individually the duty of preparing a districting plan based on careful analysis and digest of evidence which should afford the basis for the Committee's final work. At the various hearings stenographic reports were taken, making a total of about 5,000 pages, and these with the various briefs and documents filed by witnesses were reviewed by him and conclusions drawn therefrom were used as the basis for a report in which plans were laid down for drawing the district lines.

pose of testing and appraising the general drift of banking opinion throughout the nation as a whole

Opinion on the part of the banking and financial community was certainly hostile, if anything more threatening, from day to day. The bankers in many cases feared results from the new act which there was little or no reason to anticipate, believing as some did that the autocratic methods employed in passing the bill would be repeated and perhaps aggravated as the new system was put gradually into operation. There was a dread of government interference in the abstract, which, coupled with the recognition that far greater power to check abuses now resided in the hands of the administration, made some feel that they would perhaps do better to surrender their charters and reorganize under state law.

This attitude on the part of the bankers unquestionably affected the attitude of the administration. It had accomplished the unexpected—some would have said the impossible—in securing the passage of the act. But now it began to fear that the rewards of its victory might be snatched from it. Corroding influences of various kinds are always at work in every victorious political party. There are debts to be paid, enemies to be punished, possible friends to be conciliated, and the ground to be laid for the next campaign.

All these influences began to operate upon the Democratic party from the moment of its election to office in 1912, and thenceforward inevitable results of this state of things were seen throughout the entire history of the federal reserve organization process which lasted through the year 1914.

Fabian Policy Adopted

For the immediate moment, that phase of the problem of organization presented to the President was held in abeyance. It was necessary that the Organization Committee which had been provided for by law should undertake work and carry it through as nearly as possible to success before the

President should himself be called upon for further action. He had, therefore, an indefinite period (whose length no one could precisely foreshadow but which, it was early seen, probably could not be less than four or five months) within which to survey the whole field and reach his conclusions. During the purely introductory period of organization little could be done. It was admitted that selection of the members of the Federal Reserve Board prior to the completion of districting was undesirable. Accordingly there was a practically conscious determination on the part of the President and his advisers to deal with the different questions successively and to proceed on a somewhat empirical basis. First of all, let the districting be completed, then let discussion with Congress relative to the membership of the Federal Reserve Board ensue, then let the details of bank organization be taken up for determination. This method undoubtedly had its advantages, although it entailed lengthy delay. No human mind could have foreseen the coming on of the war even a short time before its actual outbreak. Had that been possible, a different point of view might have been adopted with the purpose of hastening organization. As it stood, the process of organization occupied fully nine months, but might have been accomplished in one-half of that time without, perhaps, any serious difficulty. The general decision to adopt the longer policy proved dangerous, almost disastrous, as events demonstrated, although, as already noted, through no fault of the President and only as a consequence of conditions far beyond his control.

Effect of the Outbreak of the War

It is a subject of speculation how far the President would have succeeded in carrying through his plans for the organization of the federal reserve system had not the outbreak of the war come just when he was in the midst of the process of putting the act into effect. Undoubtedly the advent of the war had many very serious and far-reaching consequences in

the early organization of the reserve system even though they were more or less obscured at the time. Of these, perhaps the first and most important was the influence exerted by the war in stilling the opposition to the system. It had been threatened at the time the act was adopted that many banks would retire from the national system, give up their charters, and pass under the jurisdiction of the states. This prediction had not been fulfilled, but on the contrary the tentative organization of the reserve banks was completed in the late spring, without more than a handful of withdrawals. It may be questioned, however, whether a much greater degree of opposition and recalcitrance would not have developed a little later. As things finally stood, the work done by the Organization Committee in districting the country was exceedingly unsatisfactory. It was announced early in April, as will later be seen, and the question immediately arose whether modifications could be obtained, and, if not, whether banks would consent to paying in the capital and surplus necessary to become full-fledged members of the new system. There is at least room for considerable doubt whether, if the more obvious defects in districting had not been corrected, many banks would actually have availed themselves of the opportunity to enter the system. Had there been any considerable number of withdrawals, the problem of organization might have been quite different, and in many respects much more serious than it was. First of all, therefore, the effect of the war was to render the opening of the system considerably easier than it might otherwise have been.

Hasty Relief Measures

The effect of the war, however, in another way impaired the prospects of the federal reserve system and rendered organization more difficult. The attention of the administration was diverted from the task of careful long-term organization of the banking machinery and was immediately directed to

hasty measures of relief. Such measures were rendered necessary upon the sudden outbreak of the war, by the fact that, as will shortly be seen, the organization of the federal reserve system had been so greatly delayed as to make it impossible to get the new mechanism into working order in time to be of early service. With prompt measures of relief in operation, it was not unnatural for those who had opposed the organization of the federal reserve system, to point to the success already obtained by these measures and to suggest that they were accomplishing quite all that was needed. It was therefore, in this view of the case, sufficient merely to continue the temporary relief plans that had been inaugurated and to trust to them for at least semi-permanent benefit. That this point of view infected members of the administration, even of the Treasury Department, is probably true. It certainly infected large numbers of the banking community who were ready to doubt the expediency of the Federal Reserve Act at all times, and in many ways made actual progress toward real installation of the reserve system extremely difficult.

Effect on Currency Situation

The effect of the war and the relief measures adopted at the outset also impeded reserve bank success in another way. As will presently be seen, the plan immediately adopted by Congress was to amend the Aldrich-Vreeland Law, thereby calling into effect a measure which had depended upon issues of currency for its operation. These issues took place on an unprecedented scale and the result was to bring about an inflated condition in banking which rendered the task of getting an actual grasp upon the credit situation very difficult. It also tended to prevent the reserve banks from receiving business for a good while and made the underlying problem of credit reorganization considerably more serious than might otherwise have been expected. This influence upon the situation diminished in importance as the months went by and as the

United States began to be relied upon more and more by foreign countries as a source from which to draw supplies which were paid for either in money or in securities, since the belligerents were not able to ship goods, being obliged to retain the bulk of their products at home for their own use. The reserve system was, however, during its early days constantly confronted with the argument, both from within and without its own ranks, that given action was undesirable so long as the Aldrich-Vreeland currency was outstanding in the amounts referred to at the time. Postponement was usually insisted upon pending the time when banking conditions should alter automatically through the retirement of this emergency currency.

Congressional Situation

The war and the attendant conditions also aggravated the congressional situation in its political aspects. Given a normal period of months within which to put the reserve system into operation, the transaction should have been attended with but little difficulty except that which was naturally involved in so large a transaction. The case was different when the question was raised concerning specially troublesome conditions said to grow out of the war and for which relief through federal reserve action was asked. Thus early in the autumn of 1914 and before the new system had been fairly launched, strong pressure was brought to bear upon it to take some action that would buoy up the price of cotton. Not only was too much expected of the system, but, in the hurry and controversy attendant upon the making of many large decisions, unwise precedents were established and actions taken that not only caused immediate trouble but returned later to plague those who would gladly have undone them when sober reflection had shown the real significance of what had been determined upon. Moreover, much valuable time was lost in discussion of temporary hand-to-mouth relief "propositions," often

thrown aside after careful analysis had shown their futility, but serving none the less to defer wise action. In this connection should be noted, too, the subtle effect of war in leading administrators to underestimate the importance of financial decisions and to regard action of every kind as subordinate to the shaping of American policy with a view to foreign relations. This may have been amply justified as a practical matter, but its effect upon the reserve system was none the less profound, and is none the less deserving of definite recognition among problems of organization which presented themselves to the Wilson administration, and to the Secretary of the Treasury under it.

Effect of Prompt Action

Had the "Fabian" policy already outlined not been resorted to and had provision been made for prompt selection of the Federal Reserve Board so soon as the district lines had been drawn, the initial organization of the Federal Reserve Board and of the banks under it might easily enough have been completed six months before the actual date of opening. In that event the system would have been ready for service contemporaneously with the outbreak of the European war and would have begun to function immediately. That this service performed at a critical moment would have been of inestimable value to the country and would correspondingly have strengthened the reserve system in the minds of the public, there can be no good reason to doubt. The system would have begun work under entirely different auspices, to say nothing of the hold that it would have acquired on the credit situation had the banking community looked to it instead of to the Comptroller of the Currency for the new notes necessary to meet the emergency caused by the sudden outbreak of the war. Great Britain's immediate demand for a settlement in gold of those outstanding obligations which at every summer season were being carried by British banks pending the receipt of the

large autumn exports of agricultural staples which the United States used for the settlement of its indebtedness, complicated matters. This, however, as already remarked, although the result of the deliberate policy of delay which had grown up in consequence of recognition of the real difficulties of the problem of organization, could not have been foreseen, and when precious weeks had been wasted, partly in executive postponement and deliberation, partly in congressional negotiation as regards nominations, the advent of the war surprised the nation and rendered prompt action practically out of the question until the immediate emergency could be met and disposed of.

Problems of Board Organization

The delay which had thus been incurred as a result of a combination of circumstances had its own effect in rendering the problem of organization more difficult from the standpoint of the Federal Reserve Board itself. As already noted, the process of organization was complex, being committed to no less than three distinct agencies—the President, the Organization Committee, and the Board. The Board itself, coming into office much later than had been expected, might have hastened action with regard to its share of the process of organization.

Character of Appointments

From the very outset of the federal reserve system, the question had to be faced whether appointments to places in the system should be made on a political basis or not. In some ways this was perhaps the most serious "organization question" that confronted the President and his administration. It affected, first of all, the appointment of the Board and the subordinate staff of that organization, the boards of directors of the reserve banks in so far as these were to be named by the Federal Reserve Board itself, and in some measure at least the personnel or staff of the federal reserve banks themselves.

It is probably well at this early point in the survey of the federal reserve organization, to make the broad general statement that during the first eight years of the operation of the system political influence in the ordinary sense of the term was held to a minimum in the making of appointments of any of these classes. How far it affected the original selection of the members of the Board itself is a serious question of judgment of which more will be said later. Subsequent appointments to the Board were not wholly free of political taint in every case, but they were seldom used as mere pawns in the political game. The Federal Reserve Board itself was at all times scrupulously careful not to be guided, in the selection of its subordinates, by recommendations of members of Congress either for or against given men and to take no account of their political affiliations.

In the first choices that were made by the Federal Reserve Board for directors of the federal reserve banks, it is probable that political influences in the narrow sense played as small a part as they could be expected to play in any such organization. A final census or survey of the choices showed that there were fully as many Republicans as there were Democrats in the list. As for the staff of the several federal reserve banks, the choice of the men was wholly in the hands of the local boards of directors, and while probably some influence could have been exerted by the Federal Reserve Board or by the administration in favor of given individuals, the present writer knows of no case of the kind and does not believe that appointments were ever made in that way. That this on the whole has been a remarkable record, few who are familiar with the history of American politics will dispute. The political taint or blemish which crept into some of the appointments to the Federal Reserve Board was the result of conditions which developed at a later date and did not affect the early membership of that organization. It should be added that, even after the onslaught of Congress in 1921-1922, the Board continued with its mem-

bership substantially unaffected by political considerations of the grosser sort and that even those members of the organization whose choice had been to some extent colored by politics were never, during the eight years here under consideration, able or perhaps disposed to pay political debts with appointments, or otherwise to carry out the wishes of executive or administration leaders

This satisfactory condition of affairs was not reached by the Wilson administration without a very strenuous effort. From the beginning rich "pickings" were recognized by politicians as existing in the federal reserve system, and multitudinous applications for "places" not only in the Board and its staff but in the banks and practically throughout the system were received. It was to the credit of the administration that it yielded so little to this heavy pressure and maintained practically from the beginning the view that the federal reserve system was to be regarded as absolutely immune to political preference or favoritism—a thing wholly isolated and apart from the usual considerations affecting appointments. That any such result could have been even approximately attained without the exertion of an iron determination on the part of President Wilson need not be questioned, and corresponding credit should be given to Mr. Wilson for thus solving by the plan of rigid self-denial what might otherwise have been one of the greatest problems and at the same time the greatest of all evils in the organization of a banking system—the presence of politicians or political hangers-on.

Anger of Politicians

This attitude, however, had not been assumed without arousing the anger of politicians. Their attitude was promptly evident in various speeches and outgivings as well as in attempts to embarrass the administration in various ways. Even within the very first few weeks after the organization

of the Board had been set up, there came to it memoranda and letters from politicians hinting at the desirability of concessions in appointments under penalties to be suffered and to be expected when the Board's annual appropriations came before Congress for adoption. Those who wrote in this manner had overlooked the fact that the Federal Reserve Act had carried an inconspicuous provision authorizing the Federal Reserve Board to obtain the necessary money for its expenses by assessing the federal reserve banks. The object of this provision had been to render the Board wholly independent of Congress and, so far as possible, of the administration. Sad experience had in the past shown the unfortunate character of conditions which existed when administrative officers were obliged to buy from Congress the funds they needed for legitimate activities by making appointments and otherwise doing the will of political managers. It may be doubted whether Congress or the administration had recognized the importance of this provision and the significance of the independence that it might bestow upon the Board, but it served an excellent purpose in the early years of the system by enabling the Board to withstand much of the pressure both from Congress and the executive branch of the government to do things which it was able to refuse but to which in other circumstances it might have had to yield. Realization by Congress that this most familiar type of coercion could not be successfully employed with the federal reserve system did not render that organization more popular and almost from the very outset it seemed to be sure of the dislike if not the positive hostility of legislative managers. How far this hostility was to go and what effect it was to have remained to be seen. Meanwhile the administration had done what it could in keeping its hands for the most part strictly off the development of the new mechanism, while Congress was obliged likewise to keep its hands off whether it would or not.

Complex Problem of Organization

Any retrospect of the year 1914 must lead to the conclusion that the problem of the federal reserve system's organization was one of extraordinary complexity. The influences centering around the choice of the Board members and the laying out of the districts, the growth of banking friction and hostility, the long delays and postponements of the administration, in bringing matters to a climax, and finally the complicating and wholly unexpected advent of the European war, all made the process of organization a matter of almost unprecedented difficulty. As has already been remarked, no one could have foreseen the course of events of the year 1914 even in the dimmest way, but, if he could, he might well have questioned the expediency of attempting to install (as one public man put it) an entirely new set of financial machinery in the ship of state while so far from port. He would probably have preferred the postponement of the entire matter until at least some light could have broken through the financial clouds which rolled up with the advent of the war, even though the necessity of some emergency means of relief had been obvious. The misfortune of the situation was the failure to organize the federal reserve system without delay, the good fortune, that there was courage enough to continue its organization even after difficulties had presented themselves.

Taking the situation all in all as it developed in 1914, the conclusion may well be reached that the situation was courageously and firmly met by the administration of President Wilson and that the reorganization of our banking system proceeded steadily and consistently. This conclusion does not imply that no mistakes were made or even that errors of judgment were not very frequent. As a matter of fact, they were numerous and serious, largely owing to the complexity of the questions to be dealt with but partly to the disposition to temporize and compromise which had begun to lessen the vigor and determination that had characterized the Wilson policy.

from the date when the Federal Reserve Act had first been resolved upon. The course of events during the year 1914 is highly instructive and throws a bright light not merely upon the working of the Federal Reserve Act itself but upon many phases of American politics and government. Of these some of the most important will be reviewed in the following pages.

CHAPTER XXIV

THE FEDERAL RESERVE DISTRICTS

Problem of District Adjustment

As was unavoidably the case, the very first work to be undertaken, in the process of putting the new system on foot, was a task which implied knowledge of and sympathy with the underlying principles of the new act, but which was to be performed by men of whom a majority at least, had little or none of either

Nothing had aroused such scorn and ridicule, nothing had been so fiercely fought in Congress, nothing had so generally been pronounced impossible, as the division of the country into several banking districts in each of which there should be a separate and independent institution. On no point had there been sharper controversy than as to the issue whether banks should be four, eight, twelve, or some other number. Yet this politically contested issue, and the much more difficult problem how to construct the several banking districts, were now to be quickly disposed of by a committee which had scant time for theoretical inquiry or practical observation.

A Unique Question

The problem itself was a very interesting question in central banking. Nothing quite like it had ever before been presented. Study of European central banking experience indicates that these central banks have usually developed by an evolutionary process. Starting as ordinary commercial institutions, they have extended their scope and influence, and have gradually built up a control over the financial markets

of the nations in which they happened to be situated. A cursory survey of European experience showed, of course, that nowhere was there a central bank whose scope of influence was such as to compare even remotely with the area of the United States or with its financial development.

Why, then, was it unreasonable to suppose that an institution could be organized in each of several districts in the United States which would successfully assume central banking powers and duties? Abstractly none whatever could be assigned, and it was just here that the opponents of the Federal Reserve Act found themselves embarrassed in their opposition. What they did not think it wise or tactful to admit, was that the United States had long been organized upon central banking lines of a sort and that the great banks in a few centers, notably in New York, had for a good while felt an ambition and developed a policy, designed to make central banks of themselves. That since, in thus developing, the country had acquired a one-sided and largely abnormal financial organization the complete rectification of it might be a type of bloodless but very painful surgery, was the real basis of their anxiety.

The problem of districting, if fairly approached, would of course result in a plan designed to allow for all such existing interrelationships so far as reasonably possible. But whatever was done must also, it was clear, make provision for banking districts which would be capable of future growth into organizations entirely capable of exercising skilfully and effectively all needful central banking functions. To draw the district lines in a way that would permit of such organization was the first problem of the Committee.

Characteristics of District

What, then, were the actually necessary characteristics of a central banking district? This question, although not put in that precise form in any of the discussion of the subject, was necessarily, in one shape or another, present in the minds of

both questioners and witnesses during the hearings. Unfortunately, before the hearings had proceeded very far, it began to be gradually thrust into the background and its place began to be taken by the question: What course is politically wisest, and can economic and banking needs be satisfied by the adoption of a plan bottomed on or controlled by political considerations? In other words, the question: What division of the country will yield the maximum benefit from the banking standpoint? was soon displaced by the question: With what minimum attention to economic requirements can political necessities be satisfied?

Nevertheless, the broad abstract question of the qualities and limits of central banking districts was not, and could not be, wholly thrust aside. Perhaps the commonest answer given to it by witnesses was seen in the repeated assertion, so positively made as to go nearly unchallenged, that such a district must be "self-contained." By this was meant that each such district must include within its boundaries a variety of seasonal demands and a combination of surplus saving, and surplus borrowing, regions, sufficient to make it a unit, meeting its own requirements and as nearly as possible independent of others either for fresh funds or for investment opportunities. Perhaps the most extreme and absurd form of this suggestion was afforded by Mr. F. A. Vanderlip, at that time the head of a national bank in New York, who recommended the creation of what he termed "shoe-string" districts—long, thin strips running north and south so as to take in many varieties of climate, industry, and yields. It has never been quite clear whether this was intended by its author as a grim joke or was a suggestion made in serious earnest.

Observance of Existing Groups

Another conception of the self-contained district was found in the view that, so far as possible, existing financial groupings ought to be observed. Hence the suggestion that there

be created a single great district comprising the northern and eastern states with headquarters at New York. Another of considerable size would have centered at Chicago and extended vaguely westward to the Rocky Mountains. A third would have comprised the Pacific Coast, while the other five districts to make up the minimum would have been carved out here and there in the South and Southwest—perhaps two being assigned to the Pacific Coast. The plan would have meant a great central bank at New York with seven other satellite banks of small capital, practically branches of the greater institution, or with possibly two satellites of first rank at Chicago and San Francisco, and five of second rank at other points.

There was a third conception of the possible division, much more rational than either of these two bizarre schemes. As has already been seen,¹ one of the formidable elements of opposition which had had to be met in framing the original act, was the demand for a curtailment of the number of banks to three or four, and later when this scheme had failed, for the "piping together" of several of the banks into independent series or units. This latter plan was once more furbished up for duty during the hearings. According to it, the Committee would have selected certain "key points" for headquarters banks. Between these—numbering, say, three—the country would have been divided. Then, to satisfy the requirements of the law and make up the minimum number of eight, two or three more institutions would have been established in each of the districts so mapped out, and these, while assigned a nominal district in each case, would have been so organized as to make them, to all intents, mere branches or dependencies of the chief banks. This scheme was advocated from the usual sources and with no little degree of skill. In this plan, there was less disposition to harp upon the notion of establishing "self-contained" districts, although one argument strongly urged in behalf of this plan was to the effect that it would

¹ Book I, Chapter XXI

result in the creation of three strong independent (or self-dependent) banks

Local Advertising

Against these various points of view urged by selfish groups, who had at all events a view of banking that was broader than mere localism would have supplied, was the demand of the various towns and cities of the country which saw in the new banking system a means of self-aggrandizement or self-advertising. As the Organization Committee pursued its travels, it found the local business and financial community in nearly every part of the country organized for the purpose of "getting" a federal reserve bank. Had the twelve institutions permitted by the law been ten times as numerous as they were, they would hardly have sufficed to supply the demand that thus made itself felt. In the West and South the notion of a self-contained district gradually faded to a mere shadow of its early self, and the local financial magnates sought only to prove the metropolitan character of their own favorite towns and cities and to establish the feasibility and desirability of placing a bank at each such point. Much of the testimony and many of the briefs that were filed read like land or travel prospectuses in which the good gifts of Providence to the different parts of the country were enumerated in the most glowing colors. The political aspects of the game soon took precedence of other considerations and the question became fundamental how to satisfy the greatest possible number of the places which were demanding the assignment of a bank.

Unessentials Discarded

The hearings held and testimony taken by the Committee, however, aided in a considerable degree to clear up various doubts and uncertainties which had long existed in the study of the districting problem. It was more and more clear, as

the work proceeded, that the notion of a self-contained district so often urged had relatively little importance. Neither could the existing financial relationships be assigned a position of much significance. Were they to be considered as a primary matter, the act itself would never have been adopted, while, on the other hand, there was in any case nothing in the statute to suggest that prevailing financial relationships must be terminated or altered. On the contrary, the act (save for a fraction of the reserve deposits) left them potentially unaltered.

It grew plain that only three considerations were to be allowed a place of first importance in determining the districting. These were (1) sufficiency of resources for, and presence of ability adequate to, the organization of a strong bank, (2) ease of access from the chief points within the district so as to permit promptness in the transmission of funds and discount applications, (3) commercial and banking relations already established and permitting successful organization to occur. As concerned the actual drawing of district lines, the problem was, of course, more complex. In his report to the Committee headed by Secretary McAdoo, the author noted the following

Available data relating to the details of the districting might be generally divided into the following classes

- (a) That relating to the importance, capital, business, and future prospects of the various places represented
- (b) That relating to the clearings and financial transactions of the various places, and their relation to other cities with reference to banking accounts and reserves carried in other banks
- (c) That relating to the habits and customs of the surrounding communities in regard to applications for loans and in regard to the distribution of their business between different cities under the present banking system
- (d) That relating to railway facilities, times of communication, and delivery of mail
- (e) That relating to the capitalization of the banks of the section, state and national, the amount of their deposits and of their reserves.

CHARACTER AND VOLUME OF LOCAL BUSINESS

Relatively little attention need be paid to the evidence with regard to the character and volume of local business, or with reference to the rapid development of such trade and industry in the past or its probable future. Under the existing banking system competition and the general course of trade have mapped out distinct channels within which funds are transferred, and have determined the distribution of banking capital upon known lines. There is nothing in the new act to alter this distribution certainly for the present, and there is no reason to believe that the main features of business, its distribution, and its character will be materially altered in the near future. They will continue about the same under the proposed system as they are today. The chief difference that will be gradually developed will be found in the fact that those who have prime commercial paper to dispose of will be able to market it in local reserve centers instead of relying upon distant financial centers. But inasmuch as the capital and reserves of the new banks are to be determined as a percentage of existing bank capital, the reserve banks represent a function, to speak mathematically, of existing banks. They cannot do more for the given section in which they are situated than their capital, contributed by existing banks, will allow. A certain limitation may of course be placed upon this statement in that some stock may be sold to the public at the discretion of the Organization Committee. This, however, will be a limited, and doubtless, exceptional, resource, and the consequence must be that in order to enlarge the resources of a reserve bank it would be necessary to develop those of existing member banks. This will be done as the wealth of the various centers develops. There is, therefore, no direct or immediate relationship between the proposed reserve bank and the business concerns of a given district which is not expressed in the capitalization of the banks of that district.

QUESTION OF CLEARINGS

In like manner, it may be said that the question of clearings is not one that is vitally essential to the locating of the new banks. Much of the testimony adduced has to do with the relative amount of clearings at given places. On the other hand, it has been frequently pointed out by witnesses that large volumes of trade are not expressed in clearings. The reason why the clearings need not be primarily considered as throwing light upon the suitability of a given point as the location of a reserve bank is found in the facts that, (a) under the existing system of banking the clearings are affected by many extra-

neous features which will disappear under the new system, (b) the precise amount of the clearings varies as between different cities and will always do so, according to the number and character of the banks and the nature of their relations with one another and with outside banks. Clearings are never a very good index of business either as to volume, nature, or strain on the financial resources of the places where they are effected. There is little need, therefore, to examine figures of clearings in seeking to place the new reserve banks. In all probability, even the most conscientious study of clearings would be found to be useless, owing to the complete alteration which will be effected so soon as the new system has been successfully put into operation and has had time to produce its results in changing the direction of remittances and in altering modes of payment.

CAPITALIZATION

Again, the bare facts as to the capitalization of the banks and trust companies of a given city or region are of only secondary importance in determining the location of reserve banks. The law specifies that no reserve bank shall be created with a smaller capitalization than \$4,000,000, and it is, therefore, necessary to obtain in every district an aggregate of banking capital which shall bear the proper relation to this minimum amount on the 6 per cent basis indicated in the law. For reasons which will be later stated, it is not believed that anything is gained by attempting to take in an unduly large amount of banking capital in any given district. Assuming these premises—one based on legislative provisions, the other upon general reasoning—the question how great or how effective is the capitalization of existing banking facilities in any particular place is not fundamentally important. The district reserve bank, if operated upon public-spirited lines, will be managed in such a way as to serve in an equitable manner the various needs of the district, and will be managed by directors who presumably represent the whole district, just as the reserve bank system will presumably be operated in the interests of the country as a whole and without effort to serve the interests of one particular section or group of persons. It may be said, therefore, that since the capitalization of the whole district will be available in its due proportion for the uses of the district in all of its varied parts, the development of a portion of this capitalization at a given point has no fundamental bearing upon the placing of the reserve bank at that point. Still less is this true in view of the provisions for the creation of branch banks.

RAILWAY FACILITIES

A very different point of view must be taken with respect to the question of railway facilities. The Federal reserve bank of a district must be located *somewhere*, and the assumption naturally is that it will be located in the place which is most accessible and from which it can best serve the community. Other things being equal, a large city is favored because it is likely to contain a correspondingly large proportion of the heavy borrowers of a community and to bring them consequently close to the reserve bank where their habits and methods can be easily inspected. It remains true, moreover, that the larger places are usually those where the railway facilities are the best.

The Federal reserve bank is, furthermore, called upon to perform the service of clearing for its members, and in order to effect this object successfully it must be within as quick and easy reach of the member banks as practicable. This is fundamentally important in getting the clearing system into effective operation, and it is believed that this clearing system will be found to be one of the most significant features of the new law. Moreover, easy communication for the purpose of prompt transmission of funds, the shipment of currency in time of necessity with as little delay as possible and the prompt receipt of deposits, as well as the affording of immediate means of communication with other Federal reserve banks, all dictate the selection of places for the head offices of such banks that are best equipped with means of communication and are able most speedily to receive from and send to their member banks such funds, checks, drafts and the like as may be required by the course of business. The testimony affords considerable valuable information on this point.

HABITS OF BORROWING

It will be worth while to devote attention to the data that have been developed with respect to the borrowing habits of the community inasmuch as these habits undoubtedly will tend to persist and it is not desirable to break them except where necessary. For example, if it is shown that a large section of the surrounding country is in the habit of dealing with point A and of discounting its paper in the banks of A, that is a consideration in favor of recognizing A as the center of the reserve district which is to include A and the territory adjacent. It is also an argument to be considered in that it indicates that A is already a financial center for that territory with well-developed lines of credit outstanding. At the same time, it should be remembered that under the new act there is nothing whatever to prevent indi-

viduals from borrowing outside of their own districts or to prevent member banks from rediscounting paper with other banks in other districts or from selling or buying in the open market. They will be able to continue their present practices in that regard. Further, the existing banking system has in some cases tended to centralize funds under an artificial method, and so to build up balances in certain points in a way that they would not naturally have developed. It is, therefore, not absolutely essential, or always possible, in laying out the districts, to pay heed to the existing practices on the part of given banks in borrowing through or from the banks of a specified city. In some cases, it may be necessary to place such borrowing banks or individuals in a district which will center at a point not heretofore regarded as the financial metropolis of the region. It may be generally said that the borrowing habits of the community should be regarded as fully as possible, in all cases where such regard does not run counter to other more forcible or controlling considerations. The testimony throws much valuable light upon these borrowing habits, and is of material assistance in determining the limits to be assigned certain districts.

QUESTION OF A LARGE BANK OR BANKS

Inspection of the records and testimony filed at the various hearings of the organization committee shows that in several places local bankers advocated the establishment of a very large bank. This was not in all cases because of the desire for an extremely high capitalization, but was in not a few, the outgrowth of a feeling that the city where the bank was to be located was entitled to a certain territory which was regarded as naturally dependent upon or ancillary to it. Thus pleas were made for a bank with a very large capital or a large territory, or both, at New York City, Chicago and St. Louis. At other places requests for large territories were filed, but in many such cases the requests were due to the converse consideration,—the necessity of including a sufficiently large territory to supply the banking capital requisite upon the percentage basis prescribed by the act, to furnish the necessary reserve bank capitalization. Some analysis may now properly be made of the two points of view thus offered.

Those who demanded the organization of a large bank on the ground that such a bank was necessary in order to supply the necessities of the borrowing community dependent upon such bank were manifestly in error, inasmuch as they assumed that the bank in question was to be primarily dependent upon its capitalization for the

means of supporting its discounts. Such is far from being the case. The act itself prescribes that the banks shall be provided shortly after their organization, not only with paid in capital, but also with very large sums in deposited reserves representing the reserve funds of member banks. These both can and should be (as they were intended to be) available for use as reserve bank loaning resources. In addition the government deposits to be made with the banks will furnish further means of supporting credits. The capital will be simply an extra or added strength to the banks. If it be contended that the bank of any given district is not large enough to meet the needs of the community the criticism really amounts to a statement that the amount of the reserves required to be deposited is not sufficient. This difficulty, if it existed, could be overcome by the banks which are jointly stockholders in the reserve bank, by simply depositing more of their funds with the reserve institution. If necessary, it will have to be corrected by enforcing a requirement that a larger percentage of reserves shall be deposited with the reserve banks. Merely to extend the area included within the territory belonging to a reserve bank would not help, because such extension would simply enlarge the area without enlarging the proportion of the capitalization of the bank to that of the member banks. In other words, as fast as the area increased and the capitalization with it, just so fast would the amount of demand or strain likely to be brought to bear upon the reserve bank be increased or extended. This means that no purpose whatever in the direction of strengthening the reserve banks is attained by enlarging the area over which they preside, assuming that a sufficient area has been included to give them a reasonable degree of capitalization at the start.

Secondly, the statement that a very large capitalization is necessary in order to inspire respect either abroad or elsewhere ignores not only the fact that the real strength of the banks lies in their holdings of reserve funds as just set forth, but also ignores the fact that the reserve system will undoubtedly be viewed as a unit by foreign countries as well as by domestic interests. There is, therefore, no argument whatever on the side of those who demand that an exceptionally large banking capital shall be assigned to some one or more of the new institutions. The contentions put forward in this connection fail to recognize the united character of the system and the fact that in case of necessity the reserve board has power to require any one of the reserve banks to come to the aid of any one or more of the others.

AVERAGE CAPITALIZATION

An estimate of the probable capitalization of the Federal banks as a whole, assuming that only the national banks enter the system at the start and that practically all of them do so, or (what comes to the same thing), that enough state banks enter to make up for any withdrawals of national banks, would give a total capitalization of about \$107,000,000. The Federal Reserve Act prescribes that the number of banks to be established shall be not less than eight or more than twelve. This means that the average capitalization of the reserve banks shall be not more than one-eighth of \$107,000,000, or \$13,350,000, and not less than one-twelfth of \$107,000,000, or \$9,000,000, in round numbers. There is nothing in the act to indicate a desire or intent on the part of its framers that none of the banks should be materially larger than the others, but on the contrary the act has specifically left a large latitude to those engaged in laying out the country into districts in order that they may exercise their best judgment in apportioning the banking capital among such districts. It is, however, obviously true that since the act requires that no reserve bank shall have a smaller capital than \$4,000,000, and since the whole tenor of the law and of the debate on it was against the creation of one overshadowing institution, the framers of the act did intend that there should be no marked or extreme disparity between the capitalization of the several banks. Inasmuch as the minimum capitalization and the number of banks is fixed, it is evident that if eight institutions were to be established on the basis already indicated, the maximum size which could be given to any one of them and yet comply with the law would be \$79,000,000, while if twelve institutions were to be established the maximum size thus assignable would be \$63,000,000. To these limits the organizers of the act could go without violating the letter of the law. Such a variation in size of the banks would, however, be a manifest violation of its spirit. The same is true of the proposal to establish three or four very large banks made by the bankers at the hearings. This latter plan in turn repeats the proposal which was urged during the debates on the bill that there should be not to exceed four reserve institutions. That plan was an alternative to the plan of a single central institution and was rejected in the same way as the central plan. If the recommendations of the bankers of New York, Chicago, and St. Louis were to be accepted, the country would be practically divided up between these centers except in so far as a fringe had to be left to comply with the requirements of the law. Worked out in practice and harmonized with one

another to some extent, the suggestions of the bankers in these three cities would lead to the establishment of eight banks of which three should be very large and five small. If the five were kept down to the minimum capitalization of \$4,000,000, there would be left \$87,000,000 for division between the three centers, or an average of \$29,000,000 as the capitalization basis for the reserve bank in each place. It is not believed that this would be a compliance with the law or that the bankers in those places submitted any evidence showing that such a capitalization should be assigned.

Assuming this reasoning to be accepted, a first approximation towards a plan for laying out the proposed districts can be arrived at as follows:

The largest of the reserve banks to be located at the principal financial centers of the country should have a capitalization whose minimum limits should be in the neighborhood of \$9,000,000, or less, and whose maximum limit should certainly not exceed \$28,000,000, and should preferably be very much smaller than that amount,—as much smaller as the convenience and customary course of business will permit.

FUNDAMENTAL PRINCIPLES

The fundamental principles of a positive nature upon which the process of districting should be carried out may now be laid down:

(a) The act calls for not less than eight nor more than twelve districts, it leaves the choice of the number within these limits entirely open and to be decided without prejudice.

(b) The plain intent of the framers of the act was to establish a number of different and independent institutions, each sufficiently strong to care for itself without the necessity in normal times of depending upon any other.

(c) The institutions to be created should, therefore, be reasonably similar to one another in size, without attempting to bring about any artificial similarity, and should be located at such points as will most nearly convenience the business of the country.

(d) The creation of any one large bank should be avoided, meaning by large bank, a bank so preponderating in importance as to make it ipso facto the most conspicuous and by far the strongest element in the system, while at the same time it should be sought to avoid the creation of two distinct classes of banks, one consisting of large, powerful institutions, the other consisting of smaller and weaker

institutions likely to become dependent upon the neighboring and stronger banks

(e) While the law requires that a minimum capital of \$4,000,000 shall be present in each and every reserve district and while this requirement must be observed, there is no harm in approaching closely to it or even in going below this limit so far as the banks are concerned, making up the deficiency by private or Government subscription, if it be true that within a reasonably near future the district will probably advance in wealth and capital so as to make the establishment of such a bank desirable

(f) Special study should be given both in establishing the districts and in establishing the point in each district where the headquarters bank is to be situated, to the facilities and speed of transportation both between such point and those at which other headquarters banks are located, and between such headquarters point and the outlying portions of the district itself.

GENERAL PROBLEM OF DISTRICTING

A general survey of the country for the purpose of districting clearly shows that several distinct problems are offered in connection with the division of the country under the Federal Reserve Act. These problems present distinct phases and vary from region to region. While it will not be possible in making assignments to proceed in a consecutive way, geographically speaking, in the division of the country, it will be well to let the work proceed so far as practicable and convenient by grand divisions or regions, recognizing the distinct character of the soil, industry, distribution of population, and transportation systems of the several portions of the continent.

A limitation to be imposed upon this general principle of procedure as well as a consideration which will aid in developing the different districts is found in the fact that to a certain extent the sites of reserve banks must be regarded as practically predetermined, as in the case of New York, Chicago, and St. Louis, the present central reserve cities. Wherever that is true, for the reasons already generally set forth in the foregoing analysis, it is possible to assign certain territory as definitely belonging to the banks to be placed in the cities aforesaid. Thereby certain definite limitations necessarily to be observed in connection with the subsequent outlining of the districts are laid down.

DIRECTION OF BUSINESS

In the division to be mapped out effort must be made to recognize the fact that business at the present time has a northern and easterly

trend In most cases the headquarters of given districts will be so located as to recognize this fact and to give the fullest possible scope to existing habits and methods, doing as little violence as possible to prevailing customs and wherever practicable adopting existing banking relationships as the basis for the new organization, particularly in its clearing phases At the same time there should be no hesitation in making changes wherever it is believed that the existing banking practice is purely artificial and where, therefore, a change will increase convenience instead of diminishing it Wherever such a change becomes necessary the effort should be to lay out the boundaries of the district in such a manner that both from the transportation standpoint, as well as from the point of view of business and manufacturing growth the new banking center will develop in harmony with the general commercial interests of the district where it is situated

QUESTION OF RESERVE HOLDINGS

Before effecting the districting as a finality it would be well to ascertain with accuracy the reserve affiliations of each and every bank in the system by obtaining from them the facts in the case as already suggested in a memorandum filed with the Organization Committee on January 8, 1914 If each bank has been asked to indicate its choice of a district or city with which to be associated these data should be considered in conjunction with the figures for reserves

It should be understood, however, that the data, whatever they may be on this subject, will not affect in any very general manner the outlines of the districts On the contrary, those general outlines must be determined by broader considerations and it may be true in many cases that there would be reasons for assigning a bank to a given district notwithstanding that its affiliations would place it elsewhere if nothing else were considered The single fact that, as is well known, and as the reports of the Comptroller show, a large number of banks have their reserve agents in New York, Chicago or St. Louis rather than in a reserve city near home is due to an artificial condition which has existed heretofore and is not a circumstance to which any particular weight should be assigned in making up the districts under the new system In a less degree and with very much greater limitation, the same may be said of the facts as to reserve holdings in the smaller reserve cities

Something needs to be said concerning the general assignment of banks to districts in different parts of the country A survey will indicate that there must be assigned to the northern and eastern part

of the country an apparently disproportionately large number of districts. In the effort to alter this plan of districting in such a way as to give to the "south" or to the "west" a larger number of districts on the ground that there should be a certain sectional equality of distribution, the difficulty of irregular distribution of population and capital will inevitably be encountered. Only two remedies could be applied in connection therewith: (a) the placing of the headquarters of given districts in that part of the country which was supposed to have been slighted—in those districts where the territory included is so great as to occupy parts of two general sections of the country, or (b) to readjust the districts themselves so as to divide up great regions in a different way and make given parts of the country independent or self controlling. Some have suggested that the districts on the Atlantic Coast be elongated while compensating capital is obtained by carrying the extreme southern states such as Mississippi, Alabama and Georgia into a district which should be allowed to run high up the Mississippi River along the eastern bank of that stream, extending over the southern part of what we have called the Great Lakes district. While this plan might be feasible, it is not believed that it would be desirable. The effect of it would be to establish too great a north and south extent of territory. The same objection would hold good of any district embracing the far southern states with the southern portion of the middle west. Moreover the districts thus created would be decidedly inferior in transportation as well as in quick clearing capacity to those which have been tentatively suggested above. It would seem that there is but one argument seriously to be considered in favor of such a plan—namely the view that any district established should, if possible, contain a variety of different interests which will make seasonal demands for loans at different times. This is the argument for so-called "shoe string" districts that has been put forward from time to time, or as others have expressed it, it is a demand for the inclusion of a lending and borrowing area within each district.

QUESTION OF LENDING AND BORROWING AREAS

As regards this argument, it should be noted that even if it be allowed full scope the idea is one which cannot be fully worked out throughout the whole process of districting. The New York and Chicago districts for example will almost necessarily be debarred from making use of it, while the same is true of sundry of the other districts in greater or less degree. This would not be a good argument

against employing the plan so far as practicable if it should be entitled to serious theoretical considerations. The question must be considered, therefore, how far such serious theoretical consideration may be granted to it. Under existing conditions the idea is one which undoubtedly should have large weight, inasmuch as today the banks of the country are habitually compelled to shift currency back and forth, relying upon one another for seasonal aid through the redistribution of their fluid resources. If conditions were to be the same under the new system as at present it would be necessary to provide for this state of things. However, the very essence of the new plan is intended to meet the condition which in the past has caused chief trouble by eliminating this necessity of interdependence between districts. The Federal Reserve Act will presumably afford a means of making each district self-supporting in a credit way so that assuming the plan to work as it is expected to work the need for mutual seasonal aid and shipments of currency will be minimized.

CHOICE OF CHIEF CITIES

In choosing the chief city of each district—that is to say the city in which the headquarters bank is to be located—two main considerations are to be borne in mind:

- (a) Existing banking relationships and associations
- (b) Geographical and transportation considerations, governing the relative ease of access of different parts of the district

In some cases it will be found that these two sets of considerations cannot be harmonized, in others that a city can be selected that will satisfy both.

Wherever possible the preference should be given to a city which has acquired a distinct leadership in the matter of business and with which the banks within the district are in the habit of dealing. Where the choice between two cities would otherwise be difficult to make on account of practical equality in the extent and importance of their commercial relationships, the city to be chosen should be that which has the advantage in case of communication. This is fundamentally desirable because of the necessities of the clearing process and the advantage to be gained from having all parts of the district within easy reach of headquarters.

LOCATION OF BRANCHES

The problem of branches is likely to be decidedly serious from the very beginning. It will be found upon a close examination of the subject that the establishment of branches will be practically out of

the question so far as any useful purpose is concerned, unless a distinct territory is assigned to each branch. This involves the question whether a district shall be broken up among a number of branches with the headquarters bank simply presiding over the series, or whether a district will be assigned to the headquarters bank just as it is assigned to each branch. In either case the problem of subdistricting each district is raised. Some of the testimony already available, obtained during the hearings before the reserve bank Organization Committee has a valuable bearing upon this subject. At some points it would require to be eked out with other information. There is, however, no purpose to be served in attempting a very careful process of subdistricting until the districts themselves have been organized so that what is said in this discussion has been confined entirely to the districts themselves without effort at the detailed study of the sub-district question.

One further point should be carefully noted in this connection. There are two ways in which the branches may be established. They may be created either (a) as mere local boards of directors charged with the duty of passing upon paper and perhaps carrying on a clearing process for the subdistrict, but without any stock of cash, without a banking house and without the power to make loans directly, merely transmitting the approved paper to the headquarters bank, or (b) as full-fledged branch banking institutions with a banking house and fixtures, a stock of coin, and a full staff of employees. Care and judgment should be exercised even in establishing branches on the first named basis and they should not be created unless they are actually needed for immediate purposes. Even in the latter event, there should be no undue haste in creating them, but the headquarters banks should be allowed to get a satisfactory start before the complicating elements involved in branch organization are allowed to enter into the problem. There will, however, be no harm in announcing at the time of the districting the probable names of cities regarded as suitable sites for branch banks, leaving the decision to be revised later if necessary, and permitting the question of branch organization to remain in the background until such time as the actual establishment of the branches is resolved upon, when the type of such organization to be adopted may be indicated.

Local Prejudice

Outside of these considerations, the factors tending to determine the drawing of district lines must necessarily be

either of a purely local character designed to meet existing prejudice and allow for it as much as possible, or must have to do with the advancement or retardation of the interests of some particular place or places or must be the product of political trafficking and bartering designed to bring about party or other alignments intended for some purpose not immediately connected with the districting itself. These were considerations of a type that might be interesting to politicians, whether bankers or not, but could have no general interest from either the scientific or the strictly financial point of view. Accordingly, in making up the tentative scheme of districts, effort was made to draw the district lines chiefly in accordance with the considerations just outlined, leaving it then to the politicians to determine how far in their judgment the work should be actually carried through upon non-partisan considerations and how far the extraneous factors already referred to should be given a place. These principles were followed in the drafting of the preliminary districting plan—based upon general analysis of the testimony which was placed before the Committee. It was an analysis designed to apportion the banks of the country upon commercial and financial lines from the point of view of convenience and financial efficiency.

Number of Banks Fundamental

In making up this or any other analysis, however, it was recognized as necessary to decide first of all how many banks should be established. The act had called for not less than eight nor more than twelve, so that the necessity of decision was very considerably limited. It might well have been asked—as it necessarily was asked mentally by those engaged on the task—whether there was any abstract reason for preferring eight, nine, ten, or more banks. As has been seen in Book I, where the history of the Federal Reserve Act was fully reviewed, there was a very good reason for desiring a number of banks sufficient to permit of local self-control, and no small

part of the controversy as to the terms of the Federal Reserve Act had centered around the question how to insure the attainment of precisely that object. It will be recalled that, in the first instance, the idea of an unlimited number of reserve banks had first been broached, the thought being that eventually one would be established at every point where local banking interests desired it and were able to furnish the resources for a strong enough institution. But as between eight and twelve the difference was not a very important matter. On the whole, a more or less careful study of the situation appeared to indicate that nine would be a convenient number of districts, the other three being reserved for later growth, when the Federal Reserve Board might determine that local interests called for the splitting off of given areas to form a new district. Subsequent developments have made it more or less questionable whether the Federal Reserve Board ever would have done any such thing, at least without very severe pressure. It would be hard to say whether Secretary McAdoo himself distinctly foreshadowed a condition of that kind, but it became early quite apparent that both he and the Comptroller of the Currency favored the designation of all twelve of the districts. This accordingly established a basis for districting which was practically essential to any success. Good districting could be done only with a practically definite decision in advance as to the total number of banks. When that was given, the problem of apportioning the country in such a way as to form the twelve best and most desirable districts became much more specific and definite.

Only a relatively limited survey was necessary by the Committee in order to reach the conclusion, moreover, that the idea of the "self-contained" districts might as well be abandoned. The United States had not developed economically upon any such basis, but with thorough and excellent railroad transportation reaching all parts of the country, with a banking system which had tended to make small country institutions

dependent upon city banks, and with a parallel tendency to interdependence of the various sections growing out of specialization of crops and industries, conditions had been developed that practically necessitated continued interdependence between the different sections. Recognizing this fact and recognizing, too, that the Federal Reserve Act had made ample provision for interdistrict accommodation, it was early determined to pay no heed to the idea of independent or self-dependent districts and to be guided only by the general commercial criteria already referred to.

One-Sided Banking Structure

These general decisions, however, only laid the groundwork for proceeding. It was necessary to recognize certain troublesome facts in the situation which would necessarily have impaired the symmetry of the districts. For long years past, the United States had been undergoing a lop-sided or one-sided development. Population was highly concentrated along the eastern seaboard, and thinly spread over the district west of the Mississippi River. Banking resources had been highly concentrated as a result of the concentration of population and industry, in part, but even more as a result of the reserve deposit system of the National Banking Act. It therefore necessarily followed that the new districts must vary greatly in size, and even when so varied must also vary greatly in banking resources. This situation necessarily implied serious difficulties.

Prominent among these difficulties was the fact that in order to bring about even an approximate balance of resources and banking strength, it would be necessary to have some of the districts enormously larger than others, while in those parts of the country where banking resources had become greatly concentrated, it would be necessary to make the districts exceptionally small. This problem was seen in its acute form on the Atlantic seaboard where New York City presented

an example of unusual specialization and concentration of banking assets. Indeed, so obvious was the difficulty involved in connection with the New York district that one over-enthusiastic advocate of the districting plan suggested that the Island of Manhattan be divided into two sections by a line in the neighborhood of Fourteenth Street, thus separating the so-called Wall Street banks from those "up-state." In this case the northern part of Manhattan together with some territory adjacent to it would have been formed into an independent district, while Wall Street and its environs would have been given a reserve bank of purely local scope, although even then of large capitalization. A similar problem was noted in dealing with the territory around Philadelphia, the problem whether to place another large bank so close to New York with very narrow margins of territory between the two districts involving no small difficulty.

These problems were of course insoluble except through the plain recognition that the one-sided development of American banking would be overcome, if at all, only by a process of natural growth, and that it was out of the question to attempt either to produce or to restrict such growth through administrative or legislative methods. It was therefore admitted from the start that the district whose headquarters were to be in New York would necessarily have a small area assigned to it, but that this area must be such as was naturally tributary to the city and must include all those banks which by custom and habit prefer to do their banking with institutions in Manhattan. Deviations from this general practice, it was conceded, should be as few as possible. On the other hand, early study of the situation clearly showed that there must be an assignment of banks both to Boston and Philadelphia. To include them with the New York district would have rendered still more unwieldy the capitalization of the bank to be located in the latter place and would correspondingly have limited the ability to take in the so-called "hunterland" which naturally

belonged to the eastern seaboard. Banks at Boston, New York, and Philadelphia were accordingly to be regarded as practically basic in any scheme of districting, and the problem relating to them was simply how to assign to each its proper territory.

Position of Chicago and the West

Surveying, further, the middle western portion of the country, it was of course obvious that Chicago, by reason of its commanding commercial position, would necessarily be the site of a reserve bank—the fourth, accordingly, whose existence must be provided for. For many years past it had been recognized that San Francisco, as the metropolis of the Pacific Coast, should have been a central reserve city and that in any plan of districting under the new act it would have to be assigned a bank. Thus five were definitely located. The question whether to place a bank at St. Louis offered considerably more difficulty. St. Louis had for many years been a central reserve city and, though it had been declining in financial significance, it still occupied a premier place. Tentatively, therefore, it could be regarded as the site of the sixth of the reserve banks which were to be distributed.

A Tentative Grouping

The problem was now considerably narrowed and might be stated as simply the question whether as many as six banks should be assigned to and were needed by the remainder of the country. Examination of transportation and financial conditions, and analysis of so much of the hearings as could legitimately be called evidence, pointed to the following very distinct areas or centers which might be regarded as properly competitors for a reserve institution:

- 1 The Great Lakes district, a bank in that region being presumably located at either Cleveland or Pittsburgh as the head of a district which would bound the New

England and New York districts on the northeast of it, and Philadelphia on its southeast

2. The Southwest, a bank presumably being located at some point in Texas or in territory adjacent thereto, and serving as the head of a district including Texas and territory carved out of adjacent states
3. The Southeast, a bank being located at some point in the old cotton states with territory running to the southern boundary of the Philadelphia district and westward to the eastern boundary of the Texas district
4. Possibly the Northwest, a bank being placed at Minneapolis or St. Paul to include territory reaching westward to the eastern boundary of the Pacific Coast district

Had these institutions been established, the total number of banks to be designated would have been ten, two being left for later growth. Had the projected Minneapolis bank been omitted, the number would have been nine. Either nine or ten was the first recommendation made to the Committee, but, as already stated, political considerations had already dictated a decision to establish the full number of twelve from the outset. Two "surplus banks" being thus left over, the question where to place them presented itself. Analysis of available capital showed that it would be possible to develop two reasonably strong districts in the Southwest, throwing one to the north probably at Kansas City and thus narrowing the area to be assigned to the Texas bank. There remained the problem of a twelfth bank and for this, it appeared, the claims of New Orleans, both geographically and otherwise, were very strong. On this basis of division, therefore, banks would have been established at New York, Philadelphia, Boston, Cleveland or Pittsburgh, Chicago, Minneapolis or St. Paul, Portland or Seattle, San Francisco, St. Louis, Kansas City, some point in Texas, some point in the cotton states or possibly at New Orleans. In studying the proposed New Orleans district, there appeared to be good reason for assign-

ing it a territory. This, however, would have practically put St. Louis out of the question as a banking point and might thus have led to the shifting of the proposed St. Louis bank to Cincinnati. The claims of Baltimore which had been strongly pressed had some basis, but the preliminary survey strongly pointed to the belief that no bank should be established south of Philadelphia and north of North Carolina. In none of the preliminary surveys of the situation was the establishment of a bank at Richmond, Virginia, ever seriously considered, although that city, like others, had early engaged special counsel of various kinds and Comptroller Williams was well known to be doing his utmost to forward its claims.

Problem of Pacific Coast

A difficulty in the situation appeared from the fact that the Northern Pacific Coast could not furnish enough national bank capital to provide the necessary capitalization for a reserve bank, although local bankers offered to undertake to secure immediate membership from enough state banks to provide the necessary amount. This, however, would have meant exceptional treatment for the Pacific Coast and eventually led Secretary McAdoo to decide against a bank at Portland or Seattle for that reason. This might have made it possible to create the institution at New Orleans while yet leaving St. Louis with a reserve bank, although it was apparent from the first that the St. Louis district was not likely to be a "natural" one and would probably always be somewhat weak. Working on this basis, with the head offices at least tentatively determined upon, it was then feasible to assign territory for them upon the principles already indicated.²

² A detailed report on this subject covering the whole question of districting, which was prepared by the author for the Organization Committee at the direction of Secretary McAdoo and was submitted to the Committee at the conclusion of its hearings. It is the only analysis (so far as known) that was made of the testimony taken by the Committee, and at the time was held confidential, no statement of it ever being published. The section of the printed report of the Committee of Technical Experts which dealt with districting was prepared by the author but discussed general principles only (the details of districting recommended being reserved for the complete confidential report).

Final Decision of Committee

While all these considerations were doubtless given some weight by the Organization Committee, the final outcome was not in accord with the general dictates of economic principles. Announcing its decision on April 2, the Organization Committee put forth a decision which contained an assignment of territory for twelve independent districts varying greatly in size and resources, as was unavoidable, and designating one city in each district as the headquarters of the federal reserve bank thereof. The places thus chosen were Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco, and the districts were designated by number from 1 to 12 in the order in which the cities have just been named. In making this choice the Committee stated six considerations by which it had been guided, substantially as follows:

- 1 Mercantile, industrial, and financial connections existing in each district
- 2 Ability of reserve bank in each district to meet legitimate demands on it
- 3 Fair division of capital among the districts
- 4 General geographical and transportation situation of the districts
- 5 Population, area, and prevalent business activities of the district
- 6 Ability of member banks of each district to provide the minimum necessary capital

Taken in the abstract, there was, as seen from the foregoing discussion, no exception to be taken to these criteria or principles of action which in general followed the lines that had been mapped out in the preliminary work of analysis of testimony and survey of the districting problem at large. The Committee, however, furnished no particular reason for the choices it had made, leaving the reader to draw his own con-

clusions concerning the degree in which the principles referred to had been put into application in any given place

Errors of Choice

While the impression left by the statement of the Committee doubtless was to the effect that it had first laid out each district and had then chosen a headquarters city within the district, the fact unquestionably was that the work had been done in the reverse order, cities being chosen first and the districts assigned to them. Remembering this, the errors of choice committed by the Committee at once became evident. Assuming that twelve places were to be designated as the headquarters of reserve banks, only a casual survey was necessary to make it clear that there was a serious error in the attempt to insert a Richmond district. No call for such a district existed or could be deduced from the evidence, and the creation of it between the Southeastern district with headquarters probably at Atlanta, and the Middle Atlantic district with its headquarters at Philadelphia, threw out of gear the districting of the entire Atlantic Coast. Elimination of the Richmond district would have made the designation of cities very much more satisfactory and the districts themselves far more symmetrical along the entire Atlantic seaboard. The insertion of the Richmond district made it necessary to give up the idea of a bank on the North Pacific Coast, an omission for which the Committee offered a kind of apology, saying that Congress would no doubt provide for another district to cover that region "in a few years." Apart from this unnecessary insertion of the Richmond district, there was very considerable ground for question as to the wisdom shown in the selection of Cleveland, the home of Secretary of War Baker, as the site for the reserve bank of the Great Lakes district.

Some other reasons for complaint appeared, among them notably the fact that New Orleans not only had not been given an independent district but had been attached to Atlanta instead

of to St. Louis, the city to which it was ordinarily regarded as tributary although of recent years that relationship had almost been reversed. But the unnecessary establishment of the Richmond district had cut off so much banking capital from Atlanta that it became necessary to extend the borders of the latter district far westward in order to get enough capital to warrant the appointment of a bank in that city. Atlanta might have been omitted and made tributary to Richmond, but the influence of Senator Hoke Smith was generally regarded as having turned the scale in favor of the inclusion of Atlanta among the twelve cities; indeed, there was a prevailing impression that the designation of Atlanta was part of a kind of political understanding covering a number of subjects.

Imperfections in Districting

More important, probably, than the erroneous selection of cities as the headquarters of reserve banks, was the imperfection that prevailed in a number of cases as related to the drawing of the district lines. Of these, perhaps the most crying example of absurdity was afforded by the inclusion of the Jersey shore opposite Manhattan in the Philadelphia district, while the extreme southern part of Connecticut was assigned to Boston notwithstanding that both were really portions of Greater New York in a business way, if in no other. Appeals from the decisions of the Committee were at a later date to lead the Federal Reserve Board to readjust the district lines and in so doing to correct most of these complaints—a matter of which more will presently be said. Meantime, however, the obvious blunders, or at all events erroneous decisions, in the work of the Committee attracted widespread attention throughout the country and led the Organization Committee to issue on April 10 (eight days after the original decision) a tart rejoinder to the critics in which it discussed in special detail the case of New Orleans and the establishment of the Richmond district. No conclusive argument, however, was sub-

mitted on either of these subjects, and the only really apposite feature of this second report was the suggestion that those who did not like it could apply to the Federal Reserve Board for a review of what had been done, if they saw fit. Eventually Congress became interested on account of the violent protest that reached that body from Baltimore and New Orleans as well as from many other quarters. In a Senate resolution adopted April 14, request was made for "copies of all briefs and written arguments made by each city" and the reasons relied upon by the Organization Committee. "In response the Committee transmitted the information called for together with a mass of statistics. Most of this material was of little interest, the really significant testimony being found in the stenographic report of the hearings which has never been published."³

APPENDIX TO CHAPTER XXIV

DECISION OF THE RESERVE BANK ORGANIZATION COMMITTEE DETERMINING THE FEDERAL RESERVE DISTRICTS AND THE LOCATION OF THE FEDERAL RESERVE BANKS

[Under the Federal reserve act approved Dec 23, 1913]

The Federal reserve act directs the reserve bank organization committee to "designate not less than 8 nor more than 12 cities, to be known as Federal reserve cities," to divide the continental United States, including Alaska, into districts, each district to contain only one of such Federal reserve cities," and to apportion the districts "with due regard to the convenience and customary course of business." The act provides that the districts may not necessarily be coterminous with any State or States.

In determining the reserve districts and in designating the cities within such districts where Federal reserve banks shall be severally

³The reply of the Organization Committee was published as Senate Document 485, 63rd Congress, 2d Session, 1914 (page 384), and entitled "Letter from the Reserve Bank Organization Committee transmitting the briefs and arguments presented to the Organization Committee of the Federal Reserve Board relative to the location of reserve districts in the United States." The material presented in this document was extensive and, while fragmentary and inconclusive, as stated in the text above, constitutes the only official collection of information on the districting question.

located, the organization committee has given full consideration to the important factors bearing upon the subject. The committee held public hearings in 18 of the leading cities from the Atlantic to the Pacific and from the Great Lakes to the Gulf, and was materially assisted thereby in determining the districts and the reserve cities.

Every reasonable opportunity has been afforded applicant cities to furnish evidence to support their claims as locations for Federal reserve banks.

More than 200 cities, through their clearing-house associations, chambers of commerce, and other representatives, were heard. Of these, 37 cities asked to be designated as the headquarters of a Federal reserve bank.

The majority of the organization committee, including its chairman and the Secretary of Agriculture, were present at all hearings, and stenographic reports of the proceedings were made for more deliberate consideration. Independent investigations were, in addition, made through the Treasury Department, and the preference of each bank as to the location of the Federal reserve bank with which it desired to be connected was ascertained by an independent card ballot addressed to each of the 7,471 national banks throughout the country which had formally assented to the provisions of the Federal reserve act.

Among the many factors which governed the committee in determining the respective districts and the selection of the cities which have been chosen were:

First The ability of the member banks within the district to provide the minimum capital of \$4,000,000 required for the Federal reserve bank, on the basis of 6 per cent of the capital stock and surplus of member banks within the district.

Second The mercantile, industrial, and financial connections existing in each district and the relations between the various portions of the district and the city selected for the location of the Federal reserve bank.

Third The probable ability of the Federal reserve bank in each district, after organization and after the provisions of the Federal reserve act shall have gone into effect, to meet the legitimate demands of business, whether normal or abnormal, in accordance with the spirit and provisions of the Federal reserve act.

Fourth The fair and equitable division of the available capital for the Federal reserve banks among the districts created.

Fifth The general geographical situation of the district, transpor-

tation lines, and the facilities for speedy communication between the Federal reserve bank and all portions of the district

Sixth The population area, and prevalent business activities of the district, whether agricultural, manufacturing, mining, or commercial, its record of growth and development in the past, and its prospects for the future

In determining the several districts the committee has endeavored to follow State lines as closely as practicable, and wherever it has been found necessary to deviate the division has been along lines which are believed to be most convenient and advantageous for the district affected

The 12 districts and the 12 cities selected for the location of the Federal reserve banks are as follows

DISTRICT No 1—*The New England States Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, and Connecticut, with the city of Boston as the location of the Federal reserve bank*

This district contains 445 national banks which have accepted the provisions of the Federal reserve act The capital stock of the Federal Reserve Bank of Boston, on the basis of 6 per cent of the total capital stock and surplus of the assenting national banks in the district, will amount to \$9,924,543

DISTRICT No 2—*The State of New York, with New York City as the location of the Federal reserve bank*

This district contains 477 national banks which have accepted the provisions of the Federal reserve act The capital stock of the Federal Reserve Bank of New York, on the basis of 6 per cent of the total capital stock and surplus of the assenting national banks in the district, will amount to \$20,621,606, and if there be added 6 per cent of the capital stock and surplus of the State banks and trust companies which have applied for membership up to April 1, 1914, the total capital stock will be \$20,687,606

DISTRICT No 3—*The States of New Jersey and Delaware and all that part of Pennsylvania located east of the western boundary of the following counties McKean, Elk, Clearfield, Cambria, and Bedford, with the Federal reserve bank in the city of Philadelphia*

This district contains 757 national banks which have accepted the provisions of the Federal reserve act The capital stock of the Federal Reserve Bank of Philadelphia, on the basis of 6 per cent of the

total capital stock and surplus of the assenting national banks in the district, will amount to \$12,488,138, and if there be added 6 per cent of the capital stock and surplus of the State banks and trust companies which have applied for membership up to April 1, 1914, the total capital stock will be \$12,500,738

DISTRICT No 4—*The State of Ohio, all that part of Pennsylvania lying west of district No 3, the counties of Marshall, Ohio, Brooke, and Hancock, in the State of West Virginia, and all that part of the State of Kentucky located east of the western boundary of the following counties Boone, Grant, Scott, Woodford, Jessamine, Garrard, Lincoln, Pulaski, and McCreary, with the city of Cleveland, Ohio, as the location of the Federal reserve bank*

This district contains 767 national banks which have accepted the provisions of the Federal Reserve Act The capital stock of the Federal Reserve Bank of Cleveland, on the basis of 6 per cent of the total capital stock and surplus of the assenting national banks in the district, will amount to \$12,007,384, and if there be added 6 per cent of the capital stock and surplus of the State banks and trust companies which have applied for membership up to April 1, 1914, the total capital stock will be \$12,500,738

DISTRICT No 5—*The District of Columbia, and the States of Maryland, Virginia, North Carolina, South Carolina, and all of West Virginia except the counties of Marshall, Ohio, Brooke, and Hancock, with the Federal reserve bank located in the city of Richmond, Va*

This district contains 475 national banks which have accepted the provisions of the Federal Reserve Act The capital stock of the Federal Reserve Bank of Richmond, on the basis of 6 per cent of the total capital stock and surplus of the assenting national banks in the district, will amount to \$6,303,301, and if there be added 6 per cent of the capital stock and surplus of the State banks and trust companies which have applied for membership up to April 1, 1914, the total capital stock will be \$6,542,713

DISTRICT No 6—*The States of Alabama, Georgia, and Florida, all that part of Tennessee located east of the western boundary of the following counties Stewart, Houston, Wayne, Humphreys, and Perry, all that part of Mississippi located south of the northern boundary of the following counties Issaquena, Sharkey, Yazoo,*

Kemper, Madison, Leake, and Neshoba, and all of the southeastern part of Louisiana located east of the western boundary of the following parishes Poinde Coupee, Iberville, Assumption, and Terrebonne, with the city of Atlanta, Ga., as the location of the Federal reserve bank

This district contains 372 national banks which have accepted the provisions of the Federal reserve act. The capital stock of the Federal Reserve Bank of Atlanta, on the basis of 6 per cent of the total capital stock and surplus of the assenting national banks in the district, will amount to \$4,641,193, and if there be added 6 per cent of the capital stock and surplus of the State banks and trust companies which have applied for membership up to April 1, 1914, the total capital stock will be \$4,702,558

DISTRICT No 7—*The State of Iowa, all that part of Wisconsin located south of the northern boundary of the following counties Vernon, Sauk, Columbia, Dodge, Washington, and Ozaukee, all of the southern peninsula of Michigan, viz, that part east of Lake Michigan, all that part of Illinois located north of a line forming the southern boundary of the following counties Hancock, Schuyler, Cass, Sangamon, Christian, Shelby, Cumberland, and Clark, and all that part of Indiana north of a line forming the southern boundary of the following counties Vigo, Clay, Owen, Monroe, Brown, Bartholomew, Jennings, Ripley, and Ohio, with the Federal reserve bank located in the city of Chicago, Ill*

This district contains 952 national banks which have accepted the provisions of the Federal reserve act. The capital stock of the Federal Reserve Bank of Chicago on the basis of 6 per cent of the total capital stock and surplus of the assenting national banks in the district, will amount to \$12,479,876, and if there be added 6 per cent of the capital stock and surplus of the State banks and trust companies which have applied for membership up to April 1, 1914, the total capital stock will be \$12,967,701

DISTRICT No 8—*The State of Arkansas, all that part of Missouri located east of the western boundary of the following counties Harrison, Daviess, Caldwell, Ray, Lafayette, Johnson, Henry, St Clair, Cedar, Dade, Lawrence, and Barry, all that part of Illinois not included in district No 7, all that part of Indiana not included in district No 7, all that part of Kentucky not included in district No 4, all that part of Tennessee not included in district No 6,*

and all that part of Mississippi not included in district No 6, with the city of St Louis, Mo, as the location of the Federal reserve bank

This district contains 458 national banks which have accepted the provisions of the Federal reserve act The capital stock of the Federal Reserve Bank of St Louis, on the basis of 6 per cent of the total capital stock and surplus of the assenting national banks in the district, will amount to \$4,990,761, and if there be added 6 per cent of the capital stock and surplus of the State banks and trust companies which have applied for membership up to April 1, 1914, the total capital stock will be \$6,367,006

DISTRICT No 9—The States of Montana, North Dakota, South Dakota, Minnesota, all that part of Wisconsin not included in district No 7, and all that part of Michigan not included in district No 7, with the city of Minneapolis, Minn, as the location of the Federal reserve bank

This district contains 687 national banks which have accepted the provisions of the Federal reserve act The capital stock of the Federal Reserve Bank of Minneapolis, on the basis of 6 per cent of the total capital stock and surplus of the assenting national banks in the district, will amount to \$4,702,925

DISTRICT No 10—The States of Kansas, Nebraska, Colorado, and Wyoming, all that part of Missouri not included in district No 8, all that part of Oklahoma north of a line forming the southern boundary of the following counties Ellis, Dewey, Blaine, Canadian, Cleveland, Pottawatomie, Seminole, Okfuskee, McIntosh, Muskogee, and Sequoyah, and all that part of New Mexico north of a line forming the southern boundary of the following counties McKinley, Sandoval, Santa Fe, San Miguel, and Umon, with the city of Kansas City, Mo, as the location of the Federal reserve bank

This district contains 836 national banks which have accepted the provisions of the Federal reserve act The capital stock of the Federal Reserve Bank of Kansas City, on the basis of 6 per cent of the total capital stock and surplus of the assenting national banks in the district, will amount to \$5,590,015, and if there be added 6 per cent of the capital stock and surplus of the State banks and trust companies which have applied for membership up to April 1, 1914, the total capital stock will be \$5,600,977

DISTRICT No 11—*The State of Texas, all that part of New Mexico not included in district No 10, all that part of Oklahoma not included in district No 10, all that part of Louisiana not included in district No 6, and the following counties in the State of Arizona Pima, Graham, Greenlee, Cochise, and Santa Cruz, with the city of Dallas, Tex, as the location of the Federal reserve bank*

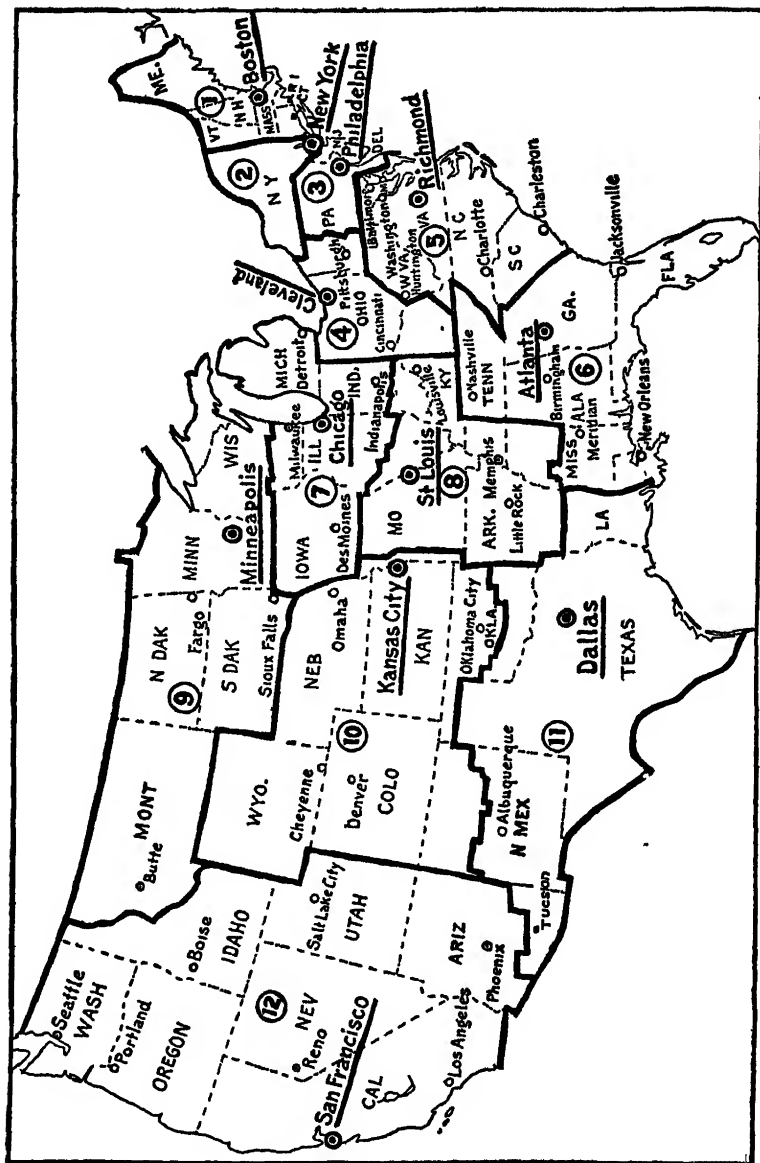
This district contains 731 national banks which have accepted the provisions of the Federal reserve act. The capital stock of the Federal Reserve Bank of Dallas, on the basis of 6 per cent of the total capital stock and surplus of the assenting national banks in the district, will amount to \$5,540,020, and if there be added 6 per cent of the capital stock and surplus of the State banks and trust companies which have applied for membership up to April 1, 1914, the total capital stock will be \$5,653,924.

DISTRICT No. 12—*The States of California, Washington, Oregon, Idaho, Nevada, and Utah, and all that part of Arizona not included in district No 11, with the city of San Francisco, Cal, as the location of the Federal reserve bank*

This district contains 514 national banks which have accepted the provisions of the Federal reserve act. The capital stock of the Federal Reserve Bank of San Francisco, on the basis of 6 per cent of the total capital stock and surplus of the assenting national banks in the district, will amount to \$7,825,375, and if there be added 6 per cent of the capital stock and surplus of the State banks and trust companies which have applied for membership up to April 1, 1914, the total capital stock will be \$8,115,494.

The committee was impressed with the growth and development of the States of Idaho, Washington, and Oregon, but on the basis of 6 per cent of the capital stock and surplus of national banks and State banks and trust companies which have applied for membership, that section could not provide the \$4,000,000 minimum capital stock required by the law. With the continued growth of that region it is reasonable to expect that in a few years the capital and surplus of its member banks will be sufficient to justify the creation of an additional Federal reserve district, at which time application may be made to the Congress for a grant of the necessary authority.

It is no part of the duty of the organization committee to locate branches of the Federal reserve banks. The law specifically provides that "each Federal reserve bank shall establish branch banks within



Map showing the Location of the Twelve Federal Reserve Banks, and the Boundaries of the Twelve Federal Reserve Districts, as determined by the Reserve Bank Organization Committee

the Federal reserve district in which it is located" All the material collected by the committee will be placed at the disposal of the Federal reserve banks and the Federal Reserve Board when they are organized and ready to consider the establishment of branch banks

W G McAdoo,

D F Houston,

JNO SKELTON WILLIAMS,

Reserve Bank Organization Committee.

WASHINGTON, D C, April 2, 1914

CHAPTER XXV

INTERNAL ORGANIZATION

Major Problems of Technique

While the reserve districts were thus in process of being shaped, the technical Organization Committee¹ had been actively prosecuting its work. It had recognized at the outset several major problems, all of which required uniform treatment in the several district institutions, and each of which was certain to present itself in one way or another by the time that the banks had been fairly opened for business.

Foremost among these problems was that of commercial paper, and the conditions of rediscounting. As to this, of course, it was possible to take a broad or a narrow position. The original plan of the act had contemplated active rediscount operations in all types of liquid commercial paper, but there could be no doubt that the language of the act leaned to the side of two-name paper in the proper sense of the term, such as bills of exchange or acceptances.

Commercial Paper

The regulations or policies suggested by the Organization Committee, therefore, sought to recognize the fact that it was intended to favor two-name paper but at the same time to admit to discount on the basis of equality with two-name paper single-name paper which constituted the staple of the portfolios of most of the smaller banks and of many of the larger ones of the country. The Committee prosecuted its inquiry with very considerable detail on this point, consulting with

¹ See p. 548

expert bankers and getting their advice, finally formulating a series of propositions with respect to the discount of paper which was eventually adopted practically in toto by the Federal Reserve Board. These propositions need not be reviewed in detail. They, in addition to recognizing the necessary eligibility of both single- and double-name paper under the Federal Reserve Act, went on to urge the necessity of confining the eligible paper with absolute strictness to that which grew out of short-term liquid business transactions. At a later date the Federal Reserve Board sought to accept these ideas and even to carry them somewhat further through the requirement of a statement which was designed to show liquid condition. The Committee would gladly have limited itself if possible to some form of paper that on its face indicated that it grew out of the sale or purchase of goods, but in the existing condition of American commercial paper practice this was impossible. As clearly appeared from even a cursory examination made of the subject, some of the best and most liquid paper of the country was not the direct result of sales of goods but represented borrowing in round figures conducted on a large scale on behalf of a concern undoubtedly liquid in its condition but not disposed to organize its financing in such a way as to furnish direct evidence of the fact that its business was actually upon that footing. The restrictions suggested by the Committee, however, were of an austere type based upon the belief that notes and bills to be taken by federal reserve banks and used by them as desired as a basis for note issue, must be of the very highest type and must represent absolutely the best paper produced in the several localities which gave rise to them.

In closing its review of the situation, the Committee outlined the chief methods of safeguarding the practice of the reserve banks with regard to commercial paper and enumerated ten principal points to be borne in mind for the future, as follows.

The following points at least are, however, deemed essential in determining the practice to be followed by reserve banks

1 Commercial paper must be broadly defined as including two-name paper given in lieu of cash for goods sold and bearing the name of maker and endorser, if discounted, and single-name paper which is largely discounted or sold to provide cash in anticipation of future purchases and sales. Where the price of the commodity involved has been fixed, two-name paper, so far as the seller is concerned, represents a closed transaction, whereas in the use of single-name paper, representing as it does principally money borrowed for future transactions, the price remains to be fixed by seasonal demand and trade limitations

2 From an economic standpoint, two-name paper may be regarded as having no inherent quality that will develop inflation, while single-name paper involving, as previously stated, future transactions, may (though not necessarily) promote speculation and thus develop price inflation. Member banks, therefore, should carefully analyze the business on which single-name paper is to be predicated, differentiating sharply, for purpose of rediscount, between that which is to be used to finance accounts receivable or strictly seasonal requirements, and that which is to finance a floating debt or be used for the extension of business that cannot be readily liquidated

3 Single-name paper, secured or unsecured, must bear the name of a solvent party whose responsibility is secured by the filing of a satisfactory statement made within one year prior to the date of the discount, or by the filing of a certified copy of such a statement by a responsible person who is in possession of the original

4 Such paper must bear the endorsement of a member bank and be accompanied by a statement attached to its schedule of application for rediscounts, signed by an officer of said bank, to the effect that to said officer's best knowledge and belief the proceeds of the notes discounted have been or are to be used for commercial, industrial or agricultural purposes *of a current nature*. Such schedule of application must be classified (on a standard form), giving the kinds of business supported by individual items

5 Such paper must have a maturity at the time of discount of not more than ninety days, except in the case of notes, drafts and bills drawn or issued for agricultural purposes or based on live stock, which may have a maturity of not exceeding six months. The total amount of such six months' paper to be taken by any one Federal reserve bank, however, shall not exceed . . . per cent of the capital of said bank

6 Any Federal Reserve Bank may discount acceptances (bank or other than consignee) based upon the importation or exportation of goods and which have at the time of discount a maturity of not more than three months and are endorsed by at least one member bank. The amount of acceptances so discounted shall at no time exceed one-half the paid up capital and surplus of the bank for which the rediscounts are made.

7 Two-name paper must bear the names of two solvent parties, the maker and the endorser. The responsibility of one being reasonably assured by customary credit statements, or the opinion of an officer or director of a member bank formally stated and filed.

8 Such paper must bear the endorsement of the member bank and be submitted on a schedule separate and apart from, that used for single-name paper, but similarly classified as to the kinds of business involved.

9 Such paper must have a maturity at the time of discount of not more than ninety days, except as provided by the act for six months' paper based upon agricultural products or live stock.

10 It is recommended as a general practice that at least one party involved in the discount of two-name paper may be required to file a statement with the member bank.

Clearances

Of fully equal importance was the attention given by the Committee to the question of clearances. Nowhere in the Federal Reserve Act, perhaps, had a more difficult or more necessary task been assigned to the Federal Reserve Board than that of providing for a system of pay clearance effective throughout the United States and designed to bring about the absolutely prompt and reliable collection of sight claims deposited in the banks. The act had necessarily left some features of this provision to be worked out, although it had enumerated the chief. It was plain, from the language of the law, that the intent of the measure was to insure the general receipt on deposit with federal reserve banks of checks and drafts upon all banks and banking organizations and their crediting to the various accounts as reserve deposits. Charges for exchange were to be prohibited, while as between federal

reserve banks themselves it was the manifest intent of the law to create an interbank clearance system

In speaking of the clearing question, the Committee recognized the necessity of (a) a clearing system providing for the clearing of items among member banks which are stockholders and depositors in any federal reserve bank, and (b) a clearing system which shall provide for clearing the transactions of federal reserve banks among themselves. Working on this as a basis the Committee went on to propose three classes of clearance. The first related to federal reserve banks and their members in the same city, and it was suggested that reserve banks should undertake to clear only those checks which were not payable through the local clearing house, the reserve banks themselves becoming members of the clearing house and so effecting a perfect clearance. Eventually, it was recognized, the federal reserve banks would probably supersede local clearing houses, taking over their functions and performing the same work which they in the past had performed. In the second place, it was recommended that in relations between reserve banks and their members outside the city, each item deposited by member banks with a federal reserve bank should become reserve "only after they had been collected," that is, placed in the possession of a paying bank and thus chargeable to the account of the drawer. Alternative to this it was suggested as "more practical and simple in operation," that member bank checks be charged against the balances of such members on the day forwarded. The working out of the technique in each alternative case was carried through by the Committee, and the choice between them was left open for later determination, while it was suggested that such items be credited to the account of the member banks on the day of receipt of the items although no bank should be allowed to draw against its uncollected funds except subject to interest. As will be seen at a later point, this plan was

adopted almost literally in developing the intradistrict collection system

Gold Settlement Fund

The mechanism of the gold settlement fund, which afterward proved to be so essentially a feature of the working of the federal reserve system during the war, was sketched in simple and concise language, which was adopted practically as it stood by the Federal Reserve Board in its subsequent establishment of the gold settlement fund for clearances between federal reserve banks

Working further with the intention of carrying out these provisions, the Committee of Experts now devoted itself, first of all, to the development of the details surrounding the organization of a central clearing. The act had permitted the placing of this clearing function either in the hands of the Federal Reserve Board or of those of one of the federal reserve banks to be designated by the Federal Reserve Board and to serve as a clearing house for the others. The latter alternative had been introduced as a matter of expediency largely for the purpose of meeting the views of those who were in the habit of contending that the Board would have no machinery with which to transact any ordinary banking operation, although there could be no question in the mind of any informed person familiar with the work of our clearing houses that the performance of these duties by the Board was a perfectly practicable undertaking. The Organization Committee accordingly recommended immediate and direct assumption of the duty by the Federal Reserve Board. It then recognized that as a basis for the management of clearing operations it would be necessary, following the custom of clearing houses in the past, to require of the participating banks that they make a gold deposit with it. It suggested that this deposit include all the gold beyond what was required by local needs, and in order to obviate objection that such

deposit would constitute an additional reserve responsibility, it recommended that deposits so made should be regarded as constituting a part of the reserve of the various federal reserve banks. Looked at in this way, the outworking of the plan merely called for the segregation of the reserve of the federal reserve banks in the hands of the Federal Reserve Board.

Two ways were noted as possibly favorable for the management of this gold fund and transfers under it. The gold might be physically handed over to the Treasurer of the United States, who could be asked to issue in exchange certificates of the denomination of \$10,000, or it might simply hand it to the Treasurer as a trust fund. In the former case, transfers in the gold settlement fund could be made from bank to bank by the actual physical shifting of gold certificates, a comparatively easy process when the certificates were in large denominations. On the other basis the transfers in the fund would take the form merely of book entries, credits and debits, according to the balances to and from each bank. On the whole, the latter process was the one which commended itself most to the Committee, but recognizing that the adoption of it might necessarily give rise to a question as to the actual custodian of a part of the reserve of the federal reserve banks, it was suggested that the former plan be pursued and that the gold deposit be handled in the form of certificates which should be actually in the possession of the Board or its officers and should by them be shifted from one bank to another. This was the plan subsequently introduced by the Board as will later appear, the method suggested by the Organization Committee being followed to the letter and the technical clearing expert who had served on the Committee being called into service to aid in the preparation of a satisfactory set of books for use in conducting the gold settlement fund.

The problem of the gold settlement fund presented no very serious difficulties, for the questions of policy which have just been outlined were not difficult to dispose of, and, when

disposed of, the technique was simple. Much more difficult was the establishment of the intradistrict system of clearing, with entries on the books of the several banks designed to bring about a collection of checks at par and to end roundabout routing of such checks which had previously been the custom. From the beginning of the Committee's work on this subject, it was recognized that the taking over of this function would necessarily interfere very seriously with the exchange methods and practices of the other banks in the community, and that these banks would eventually be driven to surrender their system of exchange charges since they would find themselves unable to compete against a system which did the work without expense. More important than this, if anything, was the recognized fact that an instantaneous debit and credit would end the tremendous system of pyramiding which had developed in the cities and would be a strong inducement to banks to send their checks immediately through to the reserve bank. The difficulty in the way, it was seen, lay in the fact that, on the one hand, country banks would be most reluctant to give up the heavy charges for exchange which they had been in the habit of exacting, while city banks would be equally reluctant to witness the introduction of a plan which must unavoidably reduce the balances carried with them by country banks throughout the United States, already depleted as these unavoidably were by the operation of the federal reserve system with its required transfers of funds from city banks to reserve banks. A careful canvass of the entire situation, however, convinced the Committee that there was no basis for expecting any easy method of overcoming these elements of friction, and it accordingly reached the conclusion that the best plan was to ignore them, or rather to allow them to take their own course and to require the immediate introduction of the clearing system which had been called for in the act, so soon at least as the reserve banks should find themselves sufficiently provided with equipment to carry on work which at the easiest

must prove to be a very serious undertaking. Accordingly a full and detailed plan was worked out, and alternative methods of making reserve credits as a result of the deposit of checks and drafts were developed.

Reporting of Condition

The subject of reporting condition was dealt with by the Committee in an exceptionally careful and effective way. Mr. J. A. Broderick, afterward Chief Examiner of the Federal Reserve Board and still later Secretary of the Board, who was a member of the Committee, had had large experience in examinations and reporting, and with his aid a thorough plan was developed whereby on a specified day each week figures of condition were to be telegraphed by each reserve bank to Washington and there combined into a general statement or balance sheet which should be given to the public. Provision was also made for a plan later put into effect by the Board upon identically the basis mapped out by the Organization Committee. This plan called for a weekly report of member banks, the figures therefor to be compiled under the direction of the federal reserve agent and then forwarded to the Board for the purpose of publishing them each week. The combined statement was designed to show the exact situation of member banks in each and every federal reserve district. Coupled with this was the development of a general plan for the examination of banks as provided for under the Federal Reserve Act. According to this plan, it was recommended that there be adopted in each federal reserve district a uniform plan of examination, to be carried on in collaboration with the national and state examiners. Examination of the federal reserve banks themselves was described, and the plan therefor outlined in some detail, while provision was made for the establishment of a credit bureau in each federal reserve bank. Such a credit bureau was eventually set up in the several reserve banks and, after a long struggle, the co-operation of the

Comptroller of the Currency was obtained in sufficient degree to permit the efficient functioning of these bureaus

Accounting

On no subject did the Committee develop more careful and detailed recommendations than on that of accounting. It of course recognized from the outset the absolute necessity of having accounting practice uniform among the twelve reserve banks, and assumed that the Board would issue regulations to that effect—an assumption later to be disappointed. It recognized also that speed in opening the new banks would be largely conditioned by the care and skill with which accounting details had been provided for. It therefore undertook to work out a complete set of accounting forms and practices. In speaking of the work thus done, the accountants connected with the Organization Committee described the purpose in mind as follows:

Our constant endeavor in devising the system of accounting for the Regional Banks has been to combine simplicity and directness of records and procedure with that comprehensiveness of control so essential in bank accounting. In the development of the system, therefore, every effort has been made to simplify and abridge the clerical routine by the use of manifold forms where initial entries could be utilized for a number of purposes, to organize the departments and procedure so that needless duplication of work and records would be avoided, and finally, by the introduction of special Departmental Settlement forms which would serve both for the departmental proof and the Auditor's control, to centralize in the Audit Division complete control over the daily operations.

Mechanical Accounting

The Committee was not satisfied to stop with the development of an ordinary system of accounting, but, recognizing that the business of reserve banks especially in the transit and clearing department would probably assume very large propor-

tions, while in government transactions it would probably run to heavy figures should the funds of the Treasury be completely transferred to the reserve institutions, it sought to work out the latest applications of mechanical accounting as used in connection with banking. With the assistance of officers of the Irving National Bank of New York, who devoted themselves to the task of aiding in this branch of the Committee's work, there was developed a complete plan of "bookkeeping without books" or loose-leaf records in which the so-called "block system of accounting" was given full scope. This system was especially adapted to use on modern typewriting and bookkeeping machines by Mr. Stephen H. Farnham of the Remington Typewriter Company. There was thus every effort to provide a plan of accounting which was not only sound theoretically, but had also been applied to the requirements of latest banking technique as well as to mechanical necessities by the assistance of experts who were pre-eminent in their own lines. This system of accounting, as will later appear, was eventually accepted by the reserve banks for their own use. It proved too elaborate (or was so considered by local bookkeepers) for comparatively limited operations and hence was displaced in favor of the orthodox type of bookkeeping in so far as related to a considerable proportion of ledger and journal transactions. The mechanical accounting system held its own in many departments at a majority of the reserve banks until the enormous expansion of operations which came with the entry of the United States into the war. Reserve accountants then found it desirable to revert as far as possible to the original plan.

Reconciliation of Plans

The two plans thus offered were both feasible and both carefully prepared, but were in many particulars mutually exclusive, so that it remained for the Board and the banks to choose between the respective ideas—a choice which resulted,

as will later be seen, in the selection of the mechanical accounting scheme as the best suited to requirements. Neither plan, however, was at any time adopted in toto and simultaneously put into operation by the several reserve banks. As time went on, the local systems of the several banks tended more and more to diverge and to draw away from one another. Eventually there was only a very vague similarity between the accounting systems and the Board never required uniformity in any save a very few respects. No more serious error of internal management was ever committed by an organization.

Foreign Exchange

The federal reserve banks in later years never permitted themselves to engage in foreign exchange transactions, save in sporadic cases during the war. There were many reasons, as the system ultimately developed, why the system was not permitted to embark upon this phase of its development. The technical Organization Committee took the act at its word and recognized foreign exchange as "the second principal element in the business of the Federal Reserve Banks." It continued

The Federal Reserve Act makes express provision not only for dealing in foreign exchange and securities but also for the mechanism necessary for such exchange transactions and finally for the regulation and control both of the foreign agencies and of the transactions themselves by the Federal Reserve Board through its regulations. It is therefore necessary to indicate first of all the conditions under which the reserve banks should operate abroad and their relations to the member banks engaged in similar business as well as to one another. It is recommended that above all in dealing in foreign exchange the Federal Reserve Banks should act together as a unit. While this is not necessary, and while the reserve banks could undoubtedly do a successful foreign exchange business independently of one another, each establishing its own agencies as it saw fit, it is believed that better results would be obtained if the reserve banks at least had general knowledge of one another's transactions and were required to act together so far as conditions would permit. It is therefore recommended that the policy to be prescribed with refer-

ence to foreign exchange by the Federal Reserve Board shall be uniform and that there shall be as little opportunity as possible for the development of conflicting or unnecessarily duplicating orders and policies. Moreover, it is believed that the establishment of agencies by each and every one of the banks would be an unnecessary expense. It is, therefore, suggested that in selecting agents or in establishing offices abroad, the reserve banks shall be required to act jointly. Joint offices for all reserve banks will ultimately need to be established in each of the principal financial centers in foreign countries and pending the time that such joint office is established, it is recommended that consent be given only to the establishment of agencies which shall jointly act for all of the Federal Reserve Banks. The details of this proposal will be fully considered in connection with the question of establishing branches in general.

Branches

Both foreign and domestic branches had been carefully provided for in the Federal Reserve Act, and the experts of the Organization Committee accordingly felt it essential to make elaborate study of the conditions under which such branches might be established—a phase of work whose results were found of utmost use when the Board began the creation of its own branches. As to the organization of such branches, two distinct plans (both later adopted in the organization of the reserve system) were set forth and their comparative merits analyzed. On this point the Committee said.

Two methods of dealing with these branches suggest themselves

- 1 The establishment of a completely organized banking house acting as a branch of the reserve bank of the district in each place where a branch may have been determined upon

- 2 The establishment of a local office only without banking machinery and equipped merely with a limited clerical organization at the service of the board of directors appointed as above provided for

These types of organization may be considered in reverse order

If it be determined to organize simply a local office the board of directors of the branch so-called would necessarily amount to nothing more than a sub-committee whose functions would be those of ascertaining the character of the paper offered for rediscount by the banks

of the community, certifying to its desirability, or disapproving it as the case might be, and then transmitting the paper for actual rediscount to the reserve bank of the district. This plan would have the advantage of avoiding the outlay necessitated by the organization of a complete branch and would also eliminate all necessity for establishing a system of accounting in the reserve bank of the district. It would also eliminate all question of necessity for a readjustment of the clearing system. On the other hand the question may be raised whether so simple a type of organization would satisfy the demands of the community in which the branch was located and would supply a sufficient addition to the mechanism of the reserve bank to warrant establishing it. Its function would obviously be only that of a credit committee passing upon particular paper. If this plan should be resorted to, it is suggested that the only records required by the branch would be those relating to offerings of paper.

On the other hand, if a full-fledged bank should be established at each branch point, it is believed that the following questions would have to be definitely considered in connection with the matter:

- 1 Relation of branch accounting to accounting of district reserve bank
- 2 Relation of method of handling checks and transit items to corresponding methods in district bank
- 3 Area or territory to be assigned to branch as special or peculiar to it, i.e., extent of sub-district within which such branch would be located
- 4 Internal organization of branch
- 5 Capitalization, if any, to be assigned to the branch

Organization of Banks and Board

Besides carefully specifying the conditions relating to commercial paper and rediscounting, clearings both national and local, examinations and reports, publication of statements, and a variety of matters ancillary to these branches of operation, the Organization Committee of technical experts also drafted forms of by-laws which eventually formed the basis first of the Board's own by-laws and then of the by-laws of the several federal reserve banks. As time went on, experience showed where modifications could well be made in these preliminary sets of by-laws and such changes were from time to time

introduced. The essential basis laid by the Organization Committee was, however, but little changed, save in minor respects which were recommended during an organization convention whose doings will be sketched in a later chapter. The by-laws of the Board itself followed closely the tentative draft which had been laid down by the Committee. Subsequent changes during the first eight years of its existence occurred only at relatively unimportant points, the conclusions being such as were indicated by the preliminary work which had been accomplished in laying out the plan beforehand. Internal organization and the bonding of federal reserve agents also occupied the attention of the Committee, and, through consultation with some of the bonding experts in sundry of the larger companies having headquarters in New York, conservative conclusions were reached and recommendations made for the adoption of a safe bonding policy on the part of the reserve banks. Many other details of technique, too numerous to consider at this point, were developed in detail, the result being to leave but little necessary work to be accomplished by the Reserve Board at the time of its organization. The intent was that the Board's attention should be entirely freed from detail. It could thereby secure opportunity to devote itself wholly to questions of policy and theory.

CHAPTER XXVI

SELECTING THE FEDERAL RESERVE BOARD

Composition of the Board

The Federal Reserve Act had placed upon the President the duty of selecting five men who, with the Secretary of the Treasury and the Comptroller of the Currency, were to make up the Federal Reserve Board. Practically the only restrictions in the law were to the effect that, of the five men thus selected, not more than one should come from any single federal reserve district, and that two of them should be experienced in banking and finance. The field of choice was thus a very large one, and while the geographical restriction was unfortunate, it was not sufficient to prevent satisfactory selection. President Wilson took the matter of selection in hand at a comparatively early date. The act had been passed on the 23rd of December, 1913, and discussion of possible choices began in "administrative circles" very shortly after the opening of the new year. The appointments were expected to be of considerable importance, and as the salary of the members had been fixed at \$12,000 per annum, thus placing them on an equality with Cabinet officers, it was believed that the selection would be given an unusual amount of attention. The banking community thought that the members of the Federal Reserve Board were intended practically to rank with members of the Cabinet—an expectation later to be greatly disappointed—and that this "Supreme Court of Finance," as the current phrase described it, would be of the utmost influence, not only in banking but in public policy.

A Misunderstanding

It was probably unfortunate that almost at the very outset there was issued in Washington—whether with official sanction or not is uncertain—a statement that the President desired no advice about the personnel of the Federal Reserve Board and that efforts to press the candidacy of given persons would constitute the surest way of defeating the selection of those persons. This statement, if in fact officially authorized, was probably never intended to have the meaning which was popularly assigned to it—that the President objected to receiving suggestions as to the personnel of the new body. It may well be doubted whether undesirable persons who really wished to make such suggestions were deterred from so doing by the statement thus disseminated. Undoubtedly, moreover, the belief that such a feeling existed at the White House prevented desirable candidates whose names would otherwise have been suggested from permitting their names to be offered.

Of more importance, however, than this unfortunate atmosphere surrounding the appointments, was the view which shortly began to be taken by some of those quite close to the administration that in selecting the new body it was desirable to represent different "sections" and "interests." Thus, for example, the view was accepted that there should be a "Wall Street man" or "New York banker" on the Board, the thought being that inasmuch as New York was the greatest financial center of the country it was in some way entitled to representation on the Board. This in itself might reasonably be doubted, since there were twelve districts and only five members to be chosen. Still less was there any reason for thinking that a resident of New York must, in order to be satisfactory, necessarily represent the inner group of banking interests which center about Wall Street.

Need of "Business Man"

Equally regrettable was the acceptance of the idea that

of the other members one should or must necessarily be a "business man," meaning thereby a man who had been actively identified with large mercantile or industrial operations. Still less was there warrant for the view that it was desirable to have a lawyer or economist as a member of the organization. These views were the outgrowth of a mistaken conception of what the new Board actually was. As has been seen elsewhere, it was distinctly planned not as a political body and not as in any sense a representative of different groups or interests, but as a central board of directors whose function it should be to operate the federal reserve system as a whole. What was to be desired, therefore, in the membership was not the "representation" of any section of the country or of a group of business interests, but simply that the new body should be capable and efficient, acquainted with the general character of the problems with which it had to deal, and above all be entirely independent of political or other extraneous considerations.

There is of course no means of knowing how far the view of the Board as a representative of different "interests" was accepted by the President, save in so far as the eventual choice of the members might be construed as a reflection of his thought on the subject. His first choice of men seemed to indicate a commitment to the idea that the members should be representative of different interests. Thus, for example, Mr. Paul M. Warburg, who was eventually confirmed as a member of the Board, was apparently chosen distinctively as standing for the views of the so-called "Wall Street group" of New York bankers.

The first choice of a business man fell upon Mr. W. D. Simmons of St. Louis, a merchant of well-known standing in the Middle West, who, however, was unable to accept the place, and the selection then turned to Mr. H. A. Wheeler of Chicago, vice-president of one of the trust companies of that city, but who felt himself likewise unable to accept appointment,

owing, it was currently reported, to the stringent requirements of the act which limited the freedom of members after leaving the Board to re-engage in banking for a stated period. From Mr. Wheeler the President's choice was transferred to Mr. Thomas D. Jones of Chicago, a lawyer, who, however, was unfavorably received by the Senate on account of his connection with the International Harvester Company which was then being prosecuted by the Department of Justice. After a vigorous effort to secure the appointment of Mr. Jones, the President finally withdrew his name at Mr. Jones' own request.

The choice then turned to Mr. Frederick A. Delano of Chicago, who had had an honorable record in connection with various railroad enterprises and who at the time was a member of the Industrial Relations Committee which had been named by the President some months previously. It had been expected from the outset that at least one member of the Board would distinctively represent the southern states, and in accordance with this forecast, the President did in fact name Mr. W. P. G. Harding of Birmingham, Alabama, who at that time was president of a large national bank in Birmingham. He and Mr. Warburg were regarded as filling the two places for which, in the language of the act, experience in banking or finance was requisite.

It had been desired from the outset to have some one technically to represent the Pacific Coast, and there had been unofficial announcement from the White House quite early in the process of selection, that the President was intending to place upon the Board one economist or scientific student of economics. Mr. A. C. Miller, at that time nominally Professor of Economics in the University of California, but actually resident in Washington as Assistant to the Secretary of the Interior, was named as the Pacific Coast representative, and the final choice fell upon Mr. Charles S. Hamlin as the representative of New England, he being a Boston lawyer who at

the time of his selection was Assistant Secretary of the Treasury¹

Senate Opposition

The Senate, indeed, had not confirmed these nominations without serious qualms. There had been no material objection to either Messrs. Harding, Hamlin, or Miller, but, as we have just seen, Mr. Jones had been completely rejected, while Mr. Warburg was eventually confirmed only after severe cross-examination and after determined opposition by a considerable group of members of the upper chamber. The appointment of Mr. Delano in place of Mr. Jones was made with little or no objection, but although the opposition of the Senate was thus centered upon two nominees, there was considerable criticism of the general character of the appointments. Some of this criticism emanated from political sources, it being asserted that of the five thus chosen, all were Democrats, while the desire of Congress and the informal promise of some of those who had urged the new measure had been that the Republican party should be given a reasonable representation upon the Board.

Although it was probably true that every one of the members of the organization eventually confirmed had voted for the existing administration, and were thus in a certain sense "Democrats," it was also true that at least two of them were far from being properly designated by that title and had no hesitation in voting the Republican or any other ticket for which they might feel a preference. In fact, the Board as eventually selected could not be said to be in any sense a political body, for even those members who were admittedly life-long Democrats had, with one possible exception, been inactive politically, and were certainly not to be classed as distinctively organization men. ~~It may fairly be said that the~~

¹ Mr. Hamlin had previously served in the same capacity during President Cleveland's second administration.

selections made by the President had thus resulted in the creation of a non-partisan Board, and the subsequent record of the Board itself in making selections and appointments in the various banks amply demonstrated that it felt no political preference and was governed by none in its choice of men

Personal Alignments

It, however, speedily appeared that the selections which had been made had been determined upon, after very careful consideration, with a view to the probable alignments of the different appointees. It was probably true, from the very beginning, that the Secretary of the Treasury could secure a practical majority for any measure or policy that he might choose to advocate. Starting with his own vote and that of the Comptroller of the Currency, he was usually able to add to this the vote of his former Assistant Secretary of the Treasury, and thus stood in need of but one more to make a clear majority upon any given subject. The division between the so-called Treasury and non-Treasury groups in the Board did not at first become apparent, but later developed itself very clearly, whether or not it was the outgrowth of any original intent—a matter as to which conclusions could be based upon conjecture only.

This situation was promptly recognized by the general banking community and was the subject of unfavorable comment, much of it biased and unfair in tone, although possessing the technical basis already indicated. On the other hand, there was at the outset no distinct grouping as between the so-called financial and other influences in the Board. If anything, it was the feeling of the financial interests that the Board was so selected as to prevent them from obtaining any such control, or at least to prevent them from starting with an apparent nucleus of votes looking to the establishment of any such control. Similarly, the Board was apparently free from sectional bias. Not only had the provisions of the law for-

bidding the choice of more than one member from any one district been of possible service in bringing about this result, but it was also true that the members themselves were practically as free from ordinary sectional prejudices as perhaps any that could have been chosen

The criticisms to be offered with reference to the selections that had been made could not rest with propriety upon any of the ordinary grounds, for reasons which have just been stated. Even the effort to retain a satisfactory Treasury majority in the Board—if it had been made—was hardly to be complained of, since the act itself had specifically created a nucleus of administrative control by making the Secretary of the Treasury and the Comptroller of the Currency ex-officio members. Legitimate criticism could be developed only upon the basis of the actual acts and temperaments of the different members as they were subsequently to be made plain through experience.

Lack of Banking Experience

Perhaps the most severe criticism to be passed at the time of organization was that the President had, to so limited an extent, exhibited any regard for knowledge and experience in his choices. It was true that one national banker had been designated, but of the remaining four only one could be said to have had direct banking experience in any large way, either from the theoretical or practical standpoint. None of the members had played any part in the actual work of forwarding the adoption of the Federal Reserve Act, while at least one had been directly opposed to its enactment, and at least one other had had membership in an organization which had been distinctly hostile throughout the whole formative period of the new law. The Secretary of the Treasury, as has been seen, had, moreover, sought to substitute another measure for the original bill or plan, and the same was true of the Comptroller of the Currency, so that the new choices represented in

this respect nothing different from the early attitude of important members of the administration

Nevertheless, it was true that the Board as first constituted was predominantly doubtful of, or actually hostile to, the law which it had been set to administer. This was perhaps an unprecedented situation, and one whose nature was possibly not known to the President, though it is difficult to suppose that the main fact could not have been before his mind in making his selections. The effort to put into effect a great and novel system of banking through the agency of a body of men possessing at the bottom little or no knowledge of, and on the whole disbelieving in, the act under which they were to operate, was, to say the least, unprecedented, the situation containing in itself elements of possible disaster whose existence could not properly be ignored. While these conditions, however, were evident to those who had been familiar with the details of the long struggle for the enactment of the new law, they were not recognized by more than a very few persons in the country at large, and it is probably true that on the whole the general attitude of the community was favorable to the selections made by the President, they being regarded as, on the face of things, sound designations.

Later Changes of Membership

In order to avoid recurring to the personnel of the Federal Reserve Board in later treatment, it is worth while to furnish at this point a brief survey of the changes in membership which occurred during its later history. According to the provisions of the act, the terms of the members had been ten years each, but the first five appointed members had been given variable terms ranging from two years up to ten. Of the original five members, the full ten-year term was given to Mr. A. C. Miller, while the short term of two years was allotted to Mr. C. S. Hamlin, who was at the outset designated as Governor of the Board. Mr. Hamlin's two years having expired in 1916, he

was renominated by President Wilson and confirmed without opposition. The four-year term had been assigned to Mr Paul M Warburg and expired in the summer of 1918. This date of expiry fell during the war and, for reasons which will appear at a later point, the President had determined (apparently) not to reappoint Mr Warburg for a second term. After his term of office had expired (he being then Vice-Governor), his seat remained vacant for a time and was then filled by the appointment of Albert Straus of New York City, a private banker formerly of the firm of J and W Seligman and Company. Mr Straus, however, retained the office only during the year 1919, being then succeeded by Edmund S Platt of New York, who was then chairman of the House Committee on Banking and Currency. Mr Delano had received the six-year term, but having determined to resign from membership of the Board, he retired at about the beginning of August, 1918, and after a lapse of some months was succeeded by Henry S Moehlenpah, a country banker of Wisconsin. Mr Moehlenpah continued for the remainder of the unexpired term of Mr Delano, which was over on August 10, 1920, and was later succeeded by John R. Mitchell of Minneapolis,² who received the first appointment made by President Harding. The eight-year term had been assigned to Mr W P G Harding and expired on August 10, 1922, at which time Mr Harding went out of office, his seat continuing vacant until January 11, 1923. In the meanwhile Congress had provided for an additional member of the Board, adopting an amendment to the Federal Reserve Act to that effect in 1922. The first appointment to fill this sixth seat was made by President Harding in the person of Milo D. Campbell, on January 11, 1923.³ The ex-officio members of the Board, the Secretary of the Treasury Mr McAdoo, and the Comptroller of the Currency Mr Williams, took office at the same date, theoretically,

² D C Willis, of Cleveland, served for a few months prior to March 4, 1921, as an interim member.

³ Mr Campbell died a few days after taking office on March 26, 1923.

as did the other members Secretary McAdoo continued in office until the close of 1918, when he was succeeded by Hon Carter Glass as Secretary of the Treasury and, accordingly, as Chairman of the Board Comptroller of the Currency Williams had received the usual five-year term as Comptroller, beginning in the summer of 1913 and therefore expiring in 1918 The Senate having refused to reconfirm him for a second term, he was nevertheless retained in office by virtue of a Department of Justice ruling until the expiry of President Wilson's second term of office on March 4, 1921 Meanwhile Secretary Glass had himself been succeeded at the opening of 1920 by David S. Houston, then Secretary of Agriculture, who became Secretary of the Treasury and Chairman of the Board, holding that office until March 4, 1921 Under the Republican administration of President Harding, Mr Andrew W Mellon of Pittsburgh succeeded to the Secretaryship of the Treasury and Chairmanship of the Board, while Mr D R Crissinger took office as Comptroller of the Currency

This review of experience shows that the turnover in the Board's membership has, on the whole, been very rapid

Delay in Choice

The process of selection had taken a long time President Wilson had not made his first choices known to the prospective candidates themselves, it would seem, before March, 1914, and he did not send to the Senate the first set of names until May of that year The Senate, as we have seen, hesitated to confirm two of the appointees, and the process of considering, examining, and finally acting upon them was not completed at the end of July It may be doubted whether the final action would not have been still further delayed, had it not been for the sudden outbreak of war in Europe, a fact which conclusively bore in upon the mind of the financial community the danger of banking disaster, and once again emphasized the unprotected condition of the United States in so far as its

currency and banking system was concerned. Had there been no such foreign cataclysm, and had conditions been suffered to drift as before, it may be doubted whether a much longer time would not have been consumed in the discussion of the personnel and individual history of the Federal Reserve Board.

The new organization was technically formed by the 10th of August, although some of the members who had been earlier confirmed by the Senate had already placed their services at the disposal of the Secretary of the Treasury in an unofficial way, in order that they might be of such service as was possible in helping to dispose of the numerous troublesome questions which attended the outbreak of the European War. The first problem to be met by the new body was that of organization. The federal reserve banks themselves not being in existence and the Board not being expected to depend upon Congress for appropriations, there was at the outset no fund for the payment of its expenses, pending the actual organization of the new banks.

The Organization Committee, consisting of the Secretary of the Treasury, the Comptroller of the Currency, and the Secretary of Agriculture, was, however, still in existence, and had by no means exhausted the fund of \$100,000 which had been appropriated to cover the cost of installing the new system. This Organization Committee had in its employ a considerable staff under the direction and control of the secretary of the Committee. At the outset it was a natural step for the Federal Reserve Board to accept the hospitality of the Organization Committee, making use of its staff and facilities so far as necessary to carry into effect the first measures which must necessarily be developed in connection with the preliminary work of organization. This staff, however, had, as already seen at an earlier point, been selected under purely political influences and was on the whole far from efficient.

The question of its continued existence or other disposition was thus one of some immediate difficulty and gave rise to

possibly the first serious difference of opinion within the Board. It was the view of the Secretary of the Treasury and the Comptroller of the Currency, who constituted the majority of the Organization Committee under whose auspices the staff had been appointed, that it simply be taken over by the Federal Reserve Board and the appointments of the several employees be confirmed and made permanent. Eventually this action was determined upon, although, as will presently be seen, it did not have the consequences which might ordinarily have been expected from it.

Internal Organization

One of the first duties undertaken by the Board was necessarily the development of a set of by-laws, and these were early formulated and adopted. They contained nothing of unusual character, following quite closely along the lines which had been mapped out in the report of the Preliminary Organization Committee, which had provided a sample set of by-laws. Included in the by-laws eventually adopted was provision for a Secretary of the Board, charged with the duty of supplying the Board with scientific analyses of banking conditions, besides acting as general executive under the direction of the Governor whose appointment had been provided for in the act. This was the beginning of a more or less elaborate organization which will be described in Chapter XXX.

CHAPTER XXVII

THE FEDERAL RESERVE SYSTEM AND THE WAR

Effect of War on Finance

The outbreak of war between Germany and the allied European powers, came to the United States, as to all other parts of the world, not merely as the shock of a great surprise but as the immediate cause of practically complete reversal of many policies and expectations which had been based upon the assumption of continued peace. In no part of our national policy did the outbreak of war create a more serious disturbance and unsettlement than in that part of it which had to do with finance and banking. Although at the outset it was not believed that there was any reason why the United States should feel serious immediate anxiety on account of the European war, and although some predicted the development of a great trade as a result of the war, it was soon seen that even under the most favorable conditions the situation would be for a good many months uncertain while the profound changes in foreign trade which almost immediately set in seemed likely, for a time at least, to be disastrous rather than profitable.

Effect on Business

It would be impossible in this discussion of the development of our banking system to attempt anything like a thorough or complete analysis of the actual financial conditions which directly resulted from the war. Yet a brief survey of the outstanding factors is essential to an understanding of contemporary and subsequent events. Two outstanding occurrences were immediately traceable to the war and should be

noted as such. They were (1) the adoption of legislation designed to provide emergency currency relief, and (2) the resort on the part of the Treasury and the new federal reserve mechanism to expedients intended to serve the place of the central banking mechanism which ought to have been earlier established.

As for the general business situation and its bearing on the federal reserve system, the outlook was well stated by the Board itself in its first annual report as follows ¹

The condition with which the Board was confronted when it began its work on the 10th of August had such a considerable bearing upon the policy pursued that it is well worthy of further notice. Seldom, if ever, has the banking and business community of the country found itself in a situation of such uncertainty and perplexity. The outbreak of hostilities in Europe led immediately to a serious rupture of international financial relationships, not only in the affected areas of Europe, but throughout the whole commercial world. The United States was directly and profoundly affected by the suspension of communication with Europe, involving as its most serious consequences the temporary breaking down of the export trade and the collapse of the financial markets, with resulting shock to the credit system. There had been extraordinary efforts on the part of European holders of American securities to realize by sales in the New York market. The securities markets were badly demoralized, prices fell with alarming rapidity, and the country was exposed to a serious and disastrous drain of gold.

The whole situation demonstrated afresh, and to a striking degree, the dependence of our banking system upon the call-loan market because of the large proportion of the country's banking reserves which were invested in call loans protected by stock-exchange collateral. Stock exchanges throughout the country closed, and call loans were thus made unavailable. Emergency currency was issued by the Secretary of the Treasury and clearing-house certificates in large volume were issued by clearing-house associations in the principal financial centers. Moreover, the tendency to hoard cash, frequently experienced in former periods of stringency, was again being manifested by country banks, some of which curtailed accommodation to an extreme degree, thereby adding greatly to the embarrassments of

¹ First Report Federal Reserve Board, 1914.

their customers and city correspondents. Much doubt was expressed as to the ability of borrowers to meet their maturing obligations, securities of high grade were unmarketable, while a situation existed in the foreign-exchange market which was altogether unprecedented. The conditions thus briefly outlined created an impression of profound alarm throughout the business community and gave rise to frequent expressions of the belief that the organization of the reserve system should be deferred until the return of more normal conditions, both for the success of the system and in order that the existing situation might not be complicated and aggravated by the injection of new and incalculable elements into it.

Amendment of Federal Reserve Act

Confronted with an unprecedented world convulsion, recognizing the fact that the machinery of the federal reserve system was still in the making and that the Board itself had not yet taken and was not likely for some time to take the oath of office and perfect its own organization, it was not strange that the Secretary of the Treasury should have felt at the very outset of the European difficulties, that he would perhaps do well to secure an amendment to the Federal Reserve Act, designed to correct the inherent defects in the Aldrich-Vreeland Law and to make emergency currency readily available in order that reassurance might be given to the banking community and that a return to specie payments at as early a date as possible might be insured. The measure which he determined to submit to Congress accordingly took the form of a supplementary provision to be incorporated in Section 27 of the Reserve Act, its terms, however, being amendatory of the so-called Aldrich-Vreeland Law of May 30, 1908. This legislation introduced changes into Section 9 of the Aldrich-Vreeland Law so as to alter the rates of taxation imposed upon new notes issued under the act and in one or two other respects to relieve the difficulties which had been found inherent in such experience as had previously been had under the old law.

The text of the legislation thus adopted by Congress is interesting in connection with the discussion of the present chapter and is therefore appended hereto verbatim as follows

AN ACT to amend section twenty-seven of an act approved December twenty-third, nineteen hundred and thirteen, and known as the Federal reserve act

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section twenty-seven of the act approved December twenty-third, nineteen hundred and thirteen, known as the Federal reserve act, is hereby amended and reenacted to read as follows

"SEC 27 The provisions of the act of May thirtieth, nineteen hundred and eight, authorizing national currency associations, the issue of additional national-bank circulation, and creating a National Monetary Commission, which expires by limitation under the terms of such act on the thirtieth day of June, nineteen hundred and fourteen, are hereby extended to June thirtieth, nineteen hundred and fifteen, and sections fifty-one hundred and fifty-three, fifty-one hundred and seventy-two, fifty-one hundred and ninety-one, and fifty-two hundred and fourteen of the Revised Statutes of the United States, which were amended by the act of May thirtieth, nineteen hundred and eight, are hereby reenacted to read as such sections read prior to May thirtieth, nineteen hundred and eight, subject to such amendments or modifications as are prescribed in this act *Provided, however,* That section nine of the act first referred to in this section is hereby amended so as to change the tax rates fixed in said act by making the portion applicable thereto read as follows

"National banking associations having circulating notes secured otherwise than by bonds of the United States, shall pay for the first three months a tax at the rate of three per centum per annum upon the average amount of such of their notes in circulation as are based upon the deposit of such securities, and afterwards an additional tax rate of one-half of one per centum per annum for each month until a tax of six per centum per annum is reached, and thereafter such tax of six per centum per annum upon the average amount of such notes *Provided further,* That whenever in his judgment he may deem it desirable, the Secretary of the Treasury shall have power to suspend the limitations imposed by section one and section three of the act referred to in this section, which prescribe that such additional circu-

lation secured otherwise than by bonds of the United States shall be issued only to national banks having circulating notes outstanding secured by the deposit of bonds of the United States to an amount not less than forty per centum of the capital stock of such banks, and to suspend also the conditions and limitations of section five of said act except that no bank shall be permitted to issue circulating notes in excess of one hundred and twenty-five per centum of its unimpaired capital and surplus. He shall require each bank and currency association to maintain on deposit in the Treasury of the United States a sum in gold sufficient in his judgment for the redemption of such notes, but in no event less than five per centum. He may permit national banks, during the period for which such provisions are suspended, to issue additional circulation under the terms and conditions of the act referred to as herein amended. *Provided further*, That the Secretary of the Treasury, in his discretion, is further authorized to extend the benefits of this act to all qualified State banks and trust companies, which have joined the Federal reserve system, or which may contract to join within fifteen days after the passage of this act."

Approved, August 4, 1914

Discussion in Senate

It might have been supposed that this proposal, far reaching as it easily might become, would attract some serious attention or discussion in Congress, but the urgency of the time was of such outstanding character as largely to set aside such dangers of obstruction as might otherwise have existed. The first draft of the amendment prepared in the Treasury Department and sent to the Senate was introduced on August 3, becoming law on the following day. Senator Owen called it to the attention of the upper chamber with the request for immediate action, noting that

The stock exchanges of all Europe have been closed, the Bank of England has suspended specie payment, the Bank of France has suspended specie payment, the Bank of Germany the same, and there is a possibility of some disturbance in our country unless we take immediate steps to prevent it.

The amendment, he explained, was designed to enable such

banks which had not 40 per cent of their capital invested in United States bonds with circulating medium issued against it, to receive emergency circulation under the Aldrich-Vreeland Act by the consent of the Treasury Department. It left the Secretary of the Treasury to suspend the limitation whenever in his judgment he might deem it desirable. Mr Owen, in referring to the financial situation of the country, pointed out

that the Nation never was in such a magnificent condition to meet this world-wide disturbance, as it is now. The banks of the country are in splendid condition generally, but to have them know that if they need it, they can get \$500,000,000 of emergency circulation, will absolutely prevent anybody demanding currency, for they will not want it. The mere fact that they know they can get it will be all that will be necessary.²

The bill passed with little explanation, it was merely emphasized—and this only for the sake of public opinion—that there was no immediate danger and that the amendment was to be regarded simply as a precautionary measure.

Action in House

The same determination, to act quickly in the emergency, was shown, when Mr Glass introduced the Owen bill in the House. There was some obstruction on the part of Messrs Murdock and Lindbergh, who were not willing to vote for an amendment to an act whose adoption they had already opposed. The bill in their opinion was designed to help the investment bankers chiefly. "The legislation that is proposed this morning is to bridge the speculators over an emergency they have encountered."³

Mr Glass had introduced the Senate bill with an amendment. This provided that the Secretary of the Treasury might

² Congressional Record, 63rd Congress, 2nd Session, p. 13087.

³ Record, *ibid.*, p. 13169.

also suspend that provision of Section 5 of the Aldrich-Vreeland Act which contained restrictions to the effect that no bank should receive any currency in excess of an amount equal to its capital and surplus and that notes in excess of \$500,000,000 should in no contingency be allowed to issue. Although Mr. Murdock considered the measure, thus amended, a material improvement over the Senate bill, he could not agree with emergency legislation which under the cry of "exigency" granted, in his opinion, greater power than ever to the Secretary of the Treasury, exposed the redemption fund of the United States once more to danger, and possibly hurt public credit. No other objection was, however, heard on the floor, speakers on both sides of the House laying aside party lines and party differences and concurring in the determination to protect the supposed interests of the public in this emergency.

Mr. Underwood defended the bankers for not having issued national bank notes up to the requirements of the law permitting emergency currency.

We were glad to have them dispose of the bonds and gradually contract that currency. We invited them to do it by passing the Glass bill last winter, and yet, under the conditions under which we invited them to do it under our own legislation, they cannot take advantage of the present law.⁴

Said Mr. Glass

Of the nearly eight hundred millions of 2 per cent bonds available for circulation, seven hundred and thirty six millions are now owned by the banks. Hence banks have little basis for additional circulation, and could not help themselves if they would without this additional legislation. If the Federal reserve system were fully organized, there would be no earthly necessity for the action proposed here today, but the Attorney General of the United States having expressed the opinion that the Federal Reserve Board can not organize until all seven members shall have been appointed and con-

⁴ Record, p. 13170

firmed, we are now proposing to bridge the difficulty by lodging with the Secretary of the Treasury for immediate use should occasion demand, this power already vested in the Federal Reserve Board, but which can not be exercised by that board to meet this exigency⁵

Conference and Passage

As soon as the bill had passed the House, it was referred back to the Senate. On the same day, August 3, Mr. Owen, authorized by the Committee on Banking and Currency, recommended the approval of the House amendment with a further amendment. The House amendment had provided for the suspension of Section 5 with its two restrictions (that no bank receive any currency over an amount equal to its capital and surplus, and that no excess above \$500,000,000 should be issued). The Senate committee recommended that the first limitation be adhered to, but that the second one be exceeded if necessary. This recommendation was agreed to and Senators Owen, Hitchcock, and Nelson were appointed as conferees.

Conference on Bill

A conference was also agreed to in the House, and Messrs Glass, Korbly, and Hayes were appointed on the part of the House. In conference the following changes were accepted by both sides: suspension limitations of Section 5 to be permitted, except that no bank be permitted to issue notes in excess of 125 per cent of its capital and surplus, and the Secretary of the Treasury to be authorized to require each bank to maintain on deposit in the Treasury a sum in gold sufficient in his judgment for the redemption of such notes, but in no event less than 5 per cent.

The conference report as thus framed was immediately agreed to and passed both Houses on the 4th of August, 1914, and the bill was signed on the same day.

⁵ Record, p. 13170

Other Measures of Relief

As elsewhere seen, certain members of the Federal Reserve Board had been confirmed without hesitation by the Senate and immediately after the opening of the war had placed themselves at the disposal of the Treasury to aid in carrying into effect the emergency relief measures of various kinds, which were in process of preparation or application. In such service, Messrs. Harding and Hamlin were especially engaged, but within ten days the full Board had been convened and had taken the oath of office, thus formally creating the organization on the 10th of August. As thus established, it had before it the choice of proceeding instantly with reserve bank organization or of continuing for the time its emergency service. It wisely regarded the latter as probably more immediately helpful, and accordingly devoted itself for some time after its formal organization to two principal schemes or plans in which the reserve system was necessarily an active factor. These were the so-called gold exchange fund and the cotton loan fund. The history of these funds had been variously presented by different writers on the subject, but the statement given in the first annual report of the Federal Reserve Board⁶ is the authentic and accurate survey of the work then undertaken and accomplished. Its salient features therefore constitute the authoritative statement of what was actually done.

Gold Exchange Fund

The Board said

One of the earliest and most trying consequences of the war was the development of a highly abnormal and artificial condition in the foreign exchange market.

This situation was due essentially to the fact that a large current balance was at the time owing to Europe, foreign holdings of American securities had been placed on the market, foreign credit facilities had been withdrawn, and our export trade had suffered a serious shock

⁶ Report, 1914

from the disorganization of shipping and the breaking down of European credit machinery immediately after the outbreak of the war. Furthermore, a large amount of American securities had been issued payable in Europe, and were about to mature.

These conditions exposed our banks to a drain of gold severe enough to endanger our entire banking structure. This, on the other hand, made it difficult for those who had to discharge obligations due in Europe to procure gold or remittances at prices equivalent to the shipment of gold. The consequence was that rates for drafts and cable transfers rose to prices which were equivalent to a substantial premium on gold.

In order to cope with this extraordinary situation, it was felt that joint action on a comprehensive plan would become necessary. The Federal Reserve Board, in conjunction with the Secretary of the Treasury, therefore, took the initiative in calling, September 4, a conference of representatives of the clearing houses of all the reserve cities. The conference had a twofold purpose. On the one hand, it sought to establish, so far as that could be done, the aggregate amount of the actual current indebtedness of the United States to Europe, and, on the other hand, to devise a means of cooperation in dealing with the situation.

The investigation undertaken by the Federal Reserve Board and the conference above mentioned disclosed the opinion that the current indebtedness of the United States to foreign countries was to be stated at approximately \$500,000,000, a sum the maturity of which was spread over a period of months. The conference also resulted in the formulation of a plan of relief. A committee of bankers appointed at this conference subsequently recommended a plan for the formation of a gold fund of \$100,000,000, which was approved by the Board on September 19, and a letter was sent to the presidents of the clearing house associations throughout the country under date of September 21, 1914, in which subscriptions aggregating this sum were asked. The Federal Reserve Board had been requested to allot the pro rata of the contributions to be made to each clearing-house district, and such allotment was made. Action upon these allotments was prompt and effective, and a total of over \$108,000,000 was subscribed.

Cotton Loan Fund

A very different kind of relief, and one whose outworking was far less helpful than that of the gold exchange fund, was

developed in the so-called cotton loan plan which was intended as a means of enabling those who are in possession of cotton to obtain a sufficient supply of credit at what were considered reasonable rates. As in the case of the gold exchange fund, the Board undertook an active share in the various negotiations which were attendant upon the undertaking. The explanation of what was actually attempted has been briefly given by the Board in part as follows:

An unusually large acreage had been planted, the season had been favorable, and a very large crop was approaching maturity. These circumstances would in any event have depressed the price of cotton, even under ordinary conditions. The closing of the cotton exchanges, both in the United States and in England was, however, precipitated by the chaotic conditions following the sudden interruption of the movement of cotton and the apprehension that, with most of the great cotton-consuming countries involved in war, a normal demand for the staple could not be expected. Prices collapsed, quotations were unobtainable, and with the markets utterly demoralized, sales were made sporadically at various points in the South at 5 cents per pound—and even lower have been reported. As the cotton planter is so largely dependent upon credit in the raising of his crop, it was necessary to provide some means of assisting him to secure such accommodations as he might require to meet the obligations he would ordinarily have provided for by the sale of his product in the open market.

Various plans of relief were brought to the attention, both of this Board and of the Secretary of the Treasury, by bankers and business men among them a suggestion for the establishment of a cotton-loan fund somewhat similar in character and management to the gold-exchange fund. Many conferences were held regarding the problem with the ultimate result that the banks of the city of New York agreed to pledge a subscription of \$50,000,000 to such a fund provided that an equal amount be raised through the clearing houses in other than cotton-producing States. The plan provided that to the \$100,000,000 thus to be raised should be added a further sum of \$35,000,000 to be contributed by banks in the cotton-producing States, provided that the \$100,000,000 should be called for in proportion as the \$35,000,000 should be subscribed and paid in. The Board was asked to pass upon this plan and gave it official sanction on October 24, 1914.

During these negotiations the Federal Reserve Board became convinced that, as in the case of the gold fund, it would be impossible to raise the money necessary to relieve the cotton situation under any plan devised simply for the general good, unless the members of the Board, even though not acting in their official capacity, should give their support and sanction to the undertaking. While very reluctant to assume any additional responsibilities, the members of the Board, acting in their individual capacity, felt impelled by the same sense of public duty which had actuated them in the case of the gold fund to respond to the call and to act as the central committee of the cotton loan fund, being satisfied that the necessities of the case demanded such action, and that public opinion would approve this step.⁷

Emergency Relief Psychological

Full credit should be given to the beneficial results of these two outstanding plans for emergency relief, and it should be recognized that, as matters stood at the time, it was practically out of the question for the Federal Reserve Board to have proceeded with its work in reserve bank organization had it not first disposed of all possible claims upon it, originating either with the Treasury or the community in the belief that real and immediate help could be given. It should, however, be always borne in mind that what was thus done produced a psychological rather than a material effect. Operations under the gold exchange fund were small and under the cotton loan fund practically zero. The machinery of both was more or less clumsy and would have worked with some difficulty in either case. However, it was not long before the early events of the war as they unrolled themselves, made it plain that there was no occasion for panic, but that on the contrary the banking system was amply in position to meet all probable demands that would be brought to bear upon it. Particularly was this true of the drain of gold which had been begun by the English banks and which, as was soon recognized, inevitably brought with it its own corrective. The policing of the North Atlantic

⁷ Report, 1914

shortly made it plain that cotton would safely move to Europe, and that as a result of intense war demand, its price would undoubtedly go to high figures. Thus, as so often is the case, the financial dangers practically cured themselves, although this fact should not be in any way taken as impairing the utility of the work done in providing reassurance and possible financial aid at the outset. But as issues were gradually cleared up, it was more and more apparent that such emergency methods were of no real use, and that what was needed above all else was prompt and effective organization of the new banking machinery provided in the Reserve Act.

CHAPTER XXVIII

THE ORGANIZATION CONVENTION¹

Problem of Bank Organization

As has been seen, the first few weeks of the period after the formal organization of the Federal Reserve Board had been spent in sporadic work growing out of the economic and financial confusion due to the outbreak of war in Europe. It was not until later that the Board began to consider with very great seriousness the immediate problem of organizing the new banks.

Strange to say, some of the members of the Board were disinclined to hasten its installation. This attitude was in part a reflection of that of the larger member banks which had failed to develop any considerable confidence in the prospective working of the act. Nevertheless, it was practically universally admitted by the members of the Board that at least the technical organization of the new banks was necessary, and it was determined to summon a convention which should meet in Washington and which should take up for consideration the various practical problems connected with the opening of the banks and the undertaking of business.

Convention Summoned

Such a convention was accordingly called for the 20th of October and met on that date. It was to embrace either the entire directorates of the several reserve banks, including both the government and the banking members, or else a substantial representation selected by the various boards of directors and

¹ Stenographic minutes (never published) of the convention sessions were made and have been availed of in writing this chapter. No detailed minutes of the committee sessions were kept.

authorized to act for them at the meeting. In addition to these directors, there were present in not a few cases governors of the banks who had been selected by the local boards, while in some, other officers were also invited. A few outside experts received special invitations, and altogether the meeting included an attendance of more than one hundred persons.

The convention was at once divided into various committees dealing with assigned topics, such as by-laws, accounting, installation of machine methods, and a variety of others, and by these committees most of the important work was done. To each committee was referred that part of the report of the Preliminary Organization Committee, whose work has already been described in Chapter XXV, which had a bearing upon its deliberations. Thus, to the committee on legal matters was referred the question of by-laws for use by the several reserve banks, to the committee on accounting was referred the two systems of accounting which had been prepared and transmitted to the Secretary of the Treasury by the Preliminary Committee, to the committee on clearance of checks was referred the recommendations of the Preliminary Committee on that subject, while corresponding distribution was made in other particulars.

In only two respects were the results of the deliberations of very great immediate importance. Discussion had not proceeded far before it was apparent that what would be essential at the very outset would be a workable set of by-laws for use by the several banks and a feasible and available set of accounts which would be practically uniform throughout all banks. While most of the reports of the various committees followed the lines which had been mapped out in the preliminary report and were accordingly ratified in a more or less routine way by the general convention, there was difficulty concerning both the by-laws and the accounting system. The committee on by-laws had had the assistance of the Board's counsel who sat with it, and had eventually modified the by-laws which had

been proposed by the Preliminary Committee in a number of particulars

Conflicting Points of View

There was comparatively little disagreement about these modifications, but it was evident from the beginning of the discussions in the general convention that there were two very distinct points of view in the meeting, the one based upon a desire to keep the federal reserve agent and all representatives of the government, including the Board, as far apart from the practical work of the banks as possible, the other based upon the idea that the Board, through its representatives, was to be accepted as a direct and constant participant in the operations of the several banks. This point of view did not prevent the tentative ratification of the by-laws as recommended by the committee of the convention which had had them under advisement, although this ratification was accompanied by various statements intended to reserve the right of the banks to modify these by-laws as they might see fit—a reservation which was later to be acted upon as conditions seemed to make it desirable in the several institutions.

As for the accounting system, the difference of opinion which had been threatening from the start, almost immediately developed itself. Necessarily the adoption of a system of accounting implied the tentative establishment of the general structure of organization within the banks. The facts in the case were clearly seen by the more practical men among the boards of directors, as well as by the bankers whom they had selected as presidents of several of the institutions. These practical bankers, therefore, took the position that, in attempting to obtain the adoption of a uniform system of accounts, the Board was practically seeking to control down to minute details their internal organization and methods of operation, and that the effort consequently represented an extreme type of government interference and control in the affairs of the banks.

Uniform Accounting Essential

Nothing could have been less warranted than this point of view, for it was evident from the outset that it would be essential, particularly at the beginning, to have the operations of the banks conducted upon a practically uniform basis, while the necessity of immediately selecting some basis and providing the necessary books of account, were the banks to be opened in the near future, was so obvious as hardly to require mention. Although heated speeches were made by various of the governors of the reserve banks (as they afterwards came to be called) to the effect that they would never submit to interference of this kind on the part of the Board, they were, before the convention finally broke up, practically obliged to accept the idea of community of action. A special committee including all the governors who were present at the convention, was formed and requested to consult with the Secretary of the Board who had been chairman of the Preliminary Organization Committee and under whose direction the accounting work of that Committee had been done.

The outcome of these consultations was to authorize the Secretary to prepare and immediately transmit at the expense of the several banks, a complete set of accounting forms, books etc., following along the line of one of the systems which had been developed by the Preliminary Committee. It is probable that this action would never have been taken had the governors of the banks been in position to provide themselves promptly with the necessary records for opening their operations upon the same basis that was to be employed by the several banks. Some of the governors, however, although "practical bankers," were anything but practical in the sense of understanding the actual technique of banking, much less of bank accounting. They had thus far not obtained cashiers, auditors, accountants, etc., and it was evident to them that even with the utmost of speed they would be unable to obtain ordinary accounting facilities were they to depend entirely upon their own efforts.

Question of Opening

The convention at Washington closed with a final action suggesting November 30 as the time for opening the new banks

The act, however, vested in the Secretary of the Treasury the power to determine when the banks should actually be established and their capital paid in. It was therefore exclusively the function of the Secretary to settle this matter and he immediately took it under advisement. The problem was one which called for courage and initiative in its solution rather than for deliberation, but, as we have seen, neither the Board nor the directorates of the several reserve banks were much inclined to leave the matter to the Secretary's sole determination.

By the end of October the currency of the country had reached what was for it at that time a very inflated condition. As a result of the operations of the extended Aldrich-Vreeland Law, some \$400,000,000 emergency notes had been issued by national banks in all parts of the country, while bankers were still in a condition of serious apprehension as to the probable results of a continued drain of gold. True, as the autumn advanced, the danger of a drain of gold had been very largely eliminated, partly through the psychological effect of the gold pool, whose operations have already been sketched, partly as a result of the restoration of confidence which reached its climax with the sinking of the German raiding fleet which had been terrorizing shipping in the North Atlantic. Nevertheless, the stock exchanges continued closed and the complete restoration of confidence was evidently some time off.

Reluctance to Start New Banks

It might have been supposed that in these circumstances there would have been great eagerness to see the new reserve institutions opened, but in fact the reverse was the case. Mem-

ber banks recognized that they would be obliged to pay into the banks at the outset, not only their proportionate share of the capital stock, but also within a very short time a substantial sum in reserve deposits. They looked upon these transfers of funds as the equivalent of a weakening of their strength, apparently regarding the addition of strength which was to come from the efficiency of the new banks as entirely problematical and uncertain. Viewing it as they did in this light, it was a natural conclusion that the draft upon their cash resources was, if possible, to be avoided. A less obvious point of view was expressed by some members of the Board who contended that, should the reserve banks be opened under the conditions which then existed, they would almost immediately be closed, inasmuch as the drain of gold would be entirely shifted to them, and they with their relatively small resources would be unable to resist it.

It was difficult to see exactly how these members sustained their argument, since the reserve banks at opening would have no demand liabilities except for their reserves which must, under the terms of the law, be maintained at a specified point and could not be drawn down below that point without incurring severe penalties. Apparently the thought of those who thus argued was that, simultaneously with the opening of the reserve banks, there would be a heavy rediscount demand which would give rise to large issues of federal reserve notes, and that the presentation of these notes for gold would result in promptly exhausting the comparatively slender gold resources of the several institutions. The fear could be logically defended only upon the assumption that the management of the reserve banks was to be almost contemptible, since under no other conditions could it be assumed that the new-fledged institutions would permit themselves to be exhausted and close almost simultaneously with their initiation. As a matter of fact, no such danger existed.

Opposition to System

Among certain of the member banks, it would seem, although this of course could never be conclusively proved, that there was a calculating and more or less far-sighted effort to prevent the reserve banks from opening, in order that they might be definitely shown to have been of no use in a period of critical emergency. There was at about this time, both among members of Congress and throughout the country, a disposition to argue that it was, after all, the Aldrich-Vreeland Act which had served the country in its hour of need at the opening of the European war, and that the Federal Reserve Act, with its "heavy and clumsy machinery," could not be called into operation in time to yield needed relief. In order to make this argument really effective and to put it into use for future political campaigns, it was very desirable to prevent the reserve banks from opening at all until the emergency had completely and thoroughly passed. How far this point of view was held as a result of conscious effort, it would be difficult to say, and no charge on the subject ever could be substantiated or should be definitely made in the absence of documentary proof. That in the minds of many bankers who opposed the act and of many politicians of the inferior sort the point of view thus broadly sketched existed, there can, however, be little doubt.

The sum total of these various forces was seen in a determined pressure upon the Secretary of the Treasury McAdoo, to defer almost indefinitely the opening of the new institutions. Falling in line with what they conceived to be the attitude of the member banks, some of the governors of the reserve banks added the weight of their influence to the broader representations already made to the Secretary of the Treasury and to the Federal Reserve Board, by stating in so many words that the banks could not be opened without weeks and months of preparation. Shortly after the October convention in Washington, it had been suggested by some that the country expected action

and that it would be well if the Secretary of the Treasury should name an early date for the first payment of the capital stock of the reserve banks. A date early in November had been tentatively mentioned and this would have implied the calling for the first instalment of reserve within about two weeks thereafter.

So soon as it was seen that early action was tentatively under consideration, the executive officers of one of the larger federal reserve banks visited the Secretary of the Treasury and plainly told him in so many words that it was "not physically possible" to open the bank on the date that had been named. Very much the same word came from other institutions, so that the Secretary of the Treasury was facing not only a general opposition to the opening of the banks at any early date, but also the positive and specific testimony of experienced practical men that the work could not be accomplished. It was a very high tribute to the determination of the Secretary of the Treasury that he was able to estimate these statements at their true value and that, having done so, he accordingly announced to the Board that he had definitely determined upon calling for the first instalment of capital on November 2, 1914.

The announcement precipitated an outburst of criticism in the Board itself, those members who had determined to oppose early opening regarding the decision as a reflection upon themselves and an imprudent or perhaps arrogant assumption of authority not to be justified by any known facts. To these men it was promptly pointed out that the act vested the power to determine the date of opening in the Secretary of the Treasury, and that in thus determining it in accordance with his best judgment he was only fulfilling the duty that had been specifically given to him by the act, whether wisely or unwisely, circumstances alone could determine. It was therefore necessary for those who opposed the attempt to open the banks at an early date, to withdraw their decision or at least to sit silent, and to this course they were accordingly reluctantly

induced Instructions were therefore sent and announcement made public with reference to the payment of the capital on the date mentioned, while this announcement was shortly followed by a second to the effect that the reserve payments themselves should be made on the 14th of November and that simultaneously therewith the new banks should be considered opened

Physical Equipment

The definite determination to open the banks at so early a date could not, however, be completed in any effective way without some prompt and intensive work First of all, it was necessary to obtain either temporary or permanent quarters To this matter local committees and various boards of directors promptly addressed themselves They were fortunately able to find in almost all of the federal reserve cities either vacant banking rooms or suitable space which could be promptly fitted up in a way that would meet their general requirements It was not true in all cases that proper or even satisfactory quarters could immediately be had, but in others the accommodations obtained were so acceptable that it was not necessary even to consider making a change until the operations of the banks had so greatly expanded as a result of subsequent war operations as to put their working staffs upon an entirely different basis Had it not been for this unexpected expansion which occurred after the United States entered the war as a belligerent, it is probable that in the large majority of cases the quarters taken by the federal reserve banks at the outset would have sufficed them for a number of years to come As it was, practically all of the banks were sufficiently comfortably housed and were able to undertake with entire facility the limited business which came to them Much aid was rendered by the sub-treasuries and, where they had vaults, the local clearing houses, in undertaking the storage and safe-keeping of

coin, notes, bullion, and valuables—a fact which rendered it unnecessary to install at the very outset an elaborate system of safes and vaults in the newly created institutions

New Accounting System Delivered

The preparation of the accounting system had, as has already been seen, been directly placed in the hands of the Secretary of the Federal Reserve Board. With the co-operation of a large printing plant, it was possible within the three weeks' time which elapsed between the close of the October convention and the opening of the new banks, to produce and deliver at each institution a complete six months' supply of forms for each of the banks which it was intended to initiate at the opening. The entire cost of the accounting forms thus supplied was in the neighborhood of \$50,000. The Secretary of the Board had at the same time been requested to make investigation as to the types of banking and bookkeeping machines to be preferred and, in order to ascertain this with certainty, had obtained the co-operation of the manufacturers in conducting practical exhibits and tests in the Treasury at Washington. These tests were supervised by a committee of auditors, and with their assistance selection was made of the different types of machines to be preferred in use by the system of accounting forms which had been supplied and a full report relating to the use of the machines, as well as to the terms and conditions under which they could be obtained, was furnished to each institution.

APPENDIX TO CHAPTER XXVIII

The following text of a letter to federal reserve banks (reproduced only so far as of general interest) affords the details relative to the proposed installation of accounting and machine systems in the different banks.

The Governors of the Federal Reserve Banks.

Gentlemen

I submit a statement with reference to the work placed in my charge relating to accounting systems for use in Federal Reserve Banks and equipment therefor, such assignment having been made partly by the Organization Committee or the Federal Reserve Board, partly by the Convention of Directors which met in Washington October 22nd, and partly by several of the Governors of the banks acting together on a later date

In January, 1914, I was requested by the Secretary of the Treasury, as Chairman of the Organization Committee, to form a preliminary committee of experts for the purpose of considering questions respecting the organization of Federal Reserve Banks This duty was carried out and part of the work of the Preliminary Organization Committee thus formed by me consisted in preparing accounting plans for the banks With expert assistance, two such plans were formulated and were presented to the Board Both were referred by the Board to the Bureau of Efficiency, U S Civil Service Commission, which, after examination of both plans, reported in favor of a system prepared under the direction of Messrs Harry E Waid and C C Robinson, of New York City, acting as expert advisers to the sub-committee on mechanical accounting which had been appointed by the Preliminary Organization Committee already described and of which I was Chairman Subsequently the two systems already mentioned were referred by the Board to Mr W P G Harding, one of the members of the Board, as a sub-committee Mr Harding carefully discussed both systems with me and finally presented to the Board a report coinciding with that of the Bureau of Efficiency This report was adopted by the Board At the convention of Directors and officers of Federal Reserve Banks held in this city on October 20-22 a sub-committee of the convention to deal with statistics and accounting was appointed This committee devoted two days' work to consideration of both the accounting systems, whose genesis has already been described and reported back to the convention favorably the same system that had already been approved by the Bureau of Efficiency and by Mr Harding—and by the Board itself A report of this committee is embodied in circular No. 11 issued by the Board, which includes the reports of committees to the convention A copy of circular No 11 is attached hereto as Exhibit A In adopting the report thus laid before it, the convention, however, expressly requested that the Board should refer the accounting system to a meeting of

Governors to be held after the close of the convention. This meeting was held on October 22nd, and there were present Mr Theodore Wold, Governor of Federal Reserve Bank of Minneapolis, Mr George J Seay, Governor, Federal Reserve Bank of Richmond, Mr Archibald Kains, Governor, Federal Reserve Bank of San Francisco, Mr Alfred L Aiken, Governor, Federal Reserve Bank of Boston, Mr Charles M Sawyer, Governor, Federal Reserve Bank of Kansas City, Mr Joseph A McCord, Governor, Federal Reserve Bank of Atlanta, Mr Oscar Wells, Governor, Federal Reserve Bank of Dallas.

Governor Benjamin Strong, Jr, Federal Reserve Bank of New York City, had already, on a previous occasion, devoted careful study to the accounting system and had approved it. Governor James B McDougal, Federal Reserve Bank of Chicago, and Governor Rolla Wells, Federal Reserve Bank of St Louis, had not at that time been elected, while Governor Charles J Rhoads, of the Federal Reserve Bank of Philadelphia, and Governor E R Fancher of the Federal Reserve Bank of Cleveland, were not present. Federal Reserve Agent D C Wills, of Cleveland had, however been a member of the committee on accounting and had devoted very careful attention to the whole subject on a previous occasion. The seven Governors who were present on October 22nd carefully reviewed the system of accounting in conjunction with Mr C C Robinson, who had been largely instrumental in framing it and with myself. At the conclusion of their investigation, the scheme of accounting was tentatively approved by them subject to further investigation on their return home, and the following requests were made of me:

- 1 To place contracts for printing the accounting forms embodied in the system, to receive orders from such of the banks as might choose to introduce them, and to distribute the forms in accordance with such orders.

- 2 To obtain bids for machines suitable for use in equipping the banks to carry bookkeeping operations involving the use of the proposed accounting system, to classify such bids and to inform the several banks of the result in order that they might, in their discretion, supply themselves with machine equipment.

Subsequently three of the banks requested me to place their actual orders for machines in accordance with the decision that might be arrived at after bids had been obtained and opened.

In accordance with the request thus made to me, I at once proceeded to place the contract for the accounting forms, having obtained the services of Mr C C Robinson as consulting expert to aid in this and other allied work. Recognizing that the time would be extremely

short before the opening of the banks, I had already obtained bids from several responsible concerns for the printing of the forms in order that if they should be adopted there might be no delay in beginning operations. It had been found when these bids were opened that most of the proposals were incomplete, owing to the fact that few concerns were equipped to handle so large an undertaking. By November 4th all the orders had been completed and shipped. It was determined that in order to prevent delay a minimum supply of forms should be shipped by express to each bank, the balance of the order to follow by freight, that the preliminary shipments should be equipped with binders and that a supply of carbon paper adequate to start the banks in the use of the forms upon the 16th of November, pending such time as they could supply themselves more fully, should be furnished. The printers were ordered to furnish those binders which in their opinion were most suitable for the purpose and to add the cost to their statement.

Upon further consideration it was deemed wise to invite to Washington the accounting officers of the several banks for the purpose of further explaining to them the accounting system and of enabling them to buy without further delay the machines needed. Invitations were accordingly sent out by telegraph for a meeting on November 2nd and at the same time manufacturers were informed that if they desired, a room would be placed at their disposal in the Treasury Building for the purpose of demonstrating their machines. Many of them availed themselves of this invitation and in consequence an exhibit of about twenty-eight machines and devices was assembled in Room 28 of the Treasury Building.

On November 2nd there met at the Treasury Department representatives of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, St. Louis, Kansas City, and San Francisco. The following banks were not represented: Minneapolis, Chicago, Dallas, and Atlanta.

The representatives of the eight banks referred to assembled in the Board Room and devoted two days to the accounting system in its practical aspects and to the testing of the various machines on the accounting forms, the forms being run through the various machines. As a result, several placed orders for the machine equipment then deemed necessary, while others prepared memoranda as to their requirements, such memoranda to guide them on their arrival at their several institutions.

As orders had been placed for three banks, six had been represented at the conference and the others notified. The results of the

investigation have thus been made available to all the institutions in question

Some bids which were received after the date set for closing the bids owing to lack of information on the part of the bidders were separately tabulated and transmitted as a supplementary list to all Governors

I desire at this point to make acknowledgment of the assistance rendered by the special committee which considered the machine bids, and of the able work of Mr C C Robinson in assisting me to carry through the requests of the Governors of the Federal Reserve Banks Without his aid it would have been impossible to finish this duty in the time available for it

This report closes the work undertaken by me at the request of the Governors for the purpose of aiding in the prompt installment of the accounting and machine systems in the several banks

Respectfully submitted,

H. PARKER WILLIS

November 10, 1914

CHAPTER XXIX

SHIFTING THE RESERVES

Reserve Question Fundamental

As was seen when discussing the congressional debate on the provisions of the Federal Reserve Act, as well as in studying the conditions which led to the formulation of the act in the first place, the proper disposition of reserves under the new régime was one of the most fundamental, if not actually the most fundamental, element in the reorganization of banking which was now to occur. The act, although its essential provisions, as has already been shown, proved to be the result of compromise, was nevertheless clear and unmistakable in its description of the reserve policy and mandatory in its instructions as to what measures should be adopted in administration. It provided for immediate transfer to the federal reserve banks of a specified minimum amount of reserve amounting approximately to 5 per cent of the entire outstanding deposit liabilities of the member banks of the system. The transfer was to be only the first in a series of transfers which, under the provisions of the original measure, would be completed three years after its enactment. Immediately upon the organization of the federal reserve banks, therefore, it became the duty of the Federal Reserve Board to arrange for the transfer of reserves. The payment of the stock instalment of the reserve banks on November 2, 1914, was consequently followed by an immediate order to members to pay in their reserves, the date for such payment being set at November 16, such payment of course relating merely to the first instalment as provided by law,

Payment in Gold

It was decided by the Board to request that this payment be, in fact, made as largely as possible in gold in order that there might be at least the nucleus of a genuine gold reserve in the hands of the reserve banks. Accordingly, in circular 10 of 1914, the Board directed the making of the transfers as just set forth, and, for the purpose of encouraging members to ship actual specie, undertook that the express charges upon such specie should be borne by the federal reserve banks, a cost of transfer which was well warranted in view of the object to be gained—that of providing the reserve banks at the outset of their career with a reasonable supply of actual gold. This circular had the desired result, a very large proportion of the funds actually paid in to cover the first instalment of reserves consisting of coined gold. It is probable that of the entire payment not less than 87 per cent was in gold of all descriptions. Estimating the reserve payments to be turned in upon a percentage basis, computed with reference to the then outstanding deposit liabilities of the three classes of banks under the old law—central reserve city banks, reserve city banks, and country banks—it had been supposed that about \$300,000,000 would be paid in. In fact, the payments amounted to approximately \$263,000,000, the difference being due to the former pyramiding of reserves, which naturally introduced an element of uncertainty and difficulty into any preliminary computation. The ease with which this first payment was made and the ease of the reserve situation after the transfers had been effected, undoubtedly came as a pleasant surprise to many banks which had dreaded the necessity of giving up their specie. It had unquestionably a very beneficial influence upon the attitude of the members toward the undertaking.

Reports of federal reserve agents showed the manner in which initial reserve payments were made by member banks from their own vaults and other correspondent banks, and the composition of reserves held on December 4, 1914.

Five of the federal reserve banks did not report the initial reserve payments received by them, but gave merely the amounts received from reserve agents for the account of member banks. The figures in column A of the table given below, therefore, are the amounts reported by them as due to member banks on December 4¹.

In the case of Dallas the amount due on December 22 was taken as being probably nearer the total reserve payment than the figures on December 4.

The percentage of gold and gold certificates to total reserves, including national bank notes, held by the 12 federal

Initial reserve payments made from member banks' own vaults and through correspondent banks

	A Total reserve payments received by the Federal reserve bank, as reported by the agent, or deposits on hand on Dec 4, 1914	B Reserve payments made by member banks from their own vaults	C Amounts deposited by correspondents to the credit of member banks	D Per cent C is of A	E Number of member banks whose initial deposits were made wholly or in part by correspondent banks	Remarks
Boston (Nov 16-17, as reported by Federal reserve agent)	\$13,796,000	\$12,763,820	\$1,032,180	7.5	81	69 banks paid in \$912,180 by transfer from vaults of correspondent banks in reserve cities; in the case of 12 banks the amount of \$120,000, reported as paid in by Boston correspondent banks, represents only part of the initial deposits of these banks, the remainder having been paid in by the banks themselves.
New York (Federal reserve agent's estimate of Dec 9, 1914)	106,000,000	103,500,000	2,500,000	2.5	90-100	In a great many cases the banks referred to in columns C to E had shipped gold or lawful money to the correspondents, on whom checks for initial deposits were drawn.
Philadelphia (reported by Federal reserve agent under date of Dec 9, 1914)	18,608,488	16,290,622	2,327,866	12.5	219	Of the total shown in column C, \$310,678 was paid in by drafts of 50 member banks on correspondents and \$2,017,190 by correspondent banks upon request of 190 member banks.
Cleveland (reported by Federal reserve agent under date of Dec 4, 1914)	16,653,603	15,830,998	822,605	4.9		

¹ Over

² Less than

¹ First Report, Federal Reserve Board, 1914

Initial reserve payments made from member banks' own vaults and through correspondent banks—Continued

	A Total reserve payments received by the Federal reserve bank, as reported by the agent, or deposits on hand on Dec. 4, 1914	B Reserve payments made by member banks from their own vaults	C Amounts deposited by correspondents to the credit of member banks	D Per cent C is of A	E Number of member banks whose initial deposits were made wholly or in part by correspondent banks	Remarks
Richmond (reported by Federal reserve agent Dec 4, 1914)	\$7,343,450	\$6,840,725			91	In many cases the interior banks treated in columns C to E sent their cash deposits to their correspondent bank, particularly at Richmond, with the request that the money be dispatched to the Federal reserve bank for their account. In some instances drafts on New York were sent to the Federal reserve bank.
Atlanta (reported by Federal reserve agent Dec 8, 1914)	\$4,532,625	4,171,518			52	Two-thirds of amount shown in column C was paid in for account of 3 banks.
Chicago (letter of Federal reserve agent, Dec 22, 1914)	\$3,772,497		\$640,190		126	Of the total number of banks stated in column E, 42 banks shipped \$269,110 from their own vaults in addition to \$185,648 deposited by their correspondents and included in the total shown in column C. The total required reserve of the latter is stated as \$390,322. 12 banks not heard from are presumed to have required their correspondents to make initial deposits for them.
St. Louis (letter of Federal reserve agent, Dec 30, 1914)	10,759,277	10,498,826	260,451	2.4	59	400 banks paid in \$10,315,927 in cash out of their own vaults. Of the 59 banks which made payment through their correspondents, 12 made additional payments of \$182,599 out of their own vaults.
Minneapolis (letter of Federal reserve agent, Dec 5, 1914)	\$8,620,062					A few member banks sent checks on their reserve agents' initial deposits by the latter for account of the former not accepted, unless the correspondent banks agreed to insist upon the return of the gold paid in.
Kansas City (letter of Federal reserve agent, Dec 15, 1914)	9,916,062	9,407,983	476,789	4.8	181	By December 15 no information had yet been received from 10 member banks with aggregate payments of reserves of \$31,200.
Dallas (letter of Federal reserve agent, Dec 22, 1914)	\$6,226,367	4,951,940			167	
San Francisco (letter of Federal reserve agent, Dec 22, 1914)	\$12,373,903		1,566,997		154	Figures given in column E do not refer to those banks which shipped the required amount of lawful money to reimburse their correspondents for making the initial reserve deposits.

¹ Reserve deposits at close of business Dec 4, 1914.
² Reserve deposits at close of business Dec 22, 1914.

reserve banks on December 4, as indicated in table below, was 87 7 per cent. The lowest percentage, 61 1 per cent, is shown for Atlanta. Minneapolis and San Francisco show a percentage in excess of 99 per cent.

Composition of reserves held by each of the Federal reserve banks and the system as a whole on Dec 4, 1914

Composition of reserves	District No 1	District No 2	District No 3	District No 4	District No 5	District No 6
	<i>Dollars</i>	<i>Dollars</i>	<i>Dollars</i>	<i>Dollars</i>	<i>Dollars</i>	<i>Dollars</i>
Gold bullion and gold certificates	59,345,130	990	14,282,780	1,702,385	1,575,525	855,000
Clearing-house certificates (silver certificates)	26,580,000	2,320,000	2,320,000	4,315,000	6,525,415	2,095,500
Total gold	13,150,145	85,961,120	17,488,190	17,131,345	8,121,190	3,059,500
Silver coin						
Silver certificates	432,771	2,061,291	1,387,777	488,284	76,464	349,300
United States notes						976,259
Clearing-house certificates (silver certificates)		4,680,000				
Total silver	432,771	6,741,291	1,387,777	488,284	76,464	1,325,559
National-bank notes	22,115	11,280	388,670	2,040		17,765
Legal tender notes	1,298,665	5,887,663	665,090	954,755	143,050	600,897
Clearing-house certificates (legal-tender notes)		7,630,000				
Total legal tender	1,298,665	13,517,663	665,090	954,755	143,050	600,897
Grand total	14,903,595	106,231,334	19,229,727	18,576,404	8,340,704	5,003,711
Per cent of gold	88 3	80 9	87 8	92 2	97 4	61 1

Composition of reserves	District No 7	District No 8	District No 9	District No 10	District No 11	District No 12	Total
	<i>Dollars</i>	<i>Dollars</i>	<i>Dollars</i>	<i>Dollars</i>	<i>Dollars</i>	<i>Dollars</i>	<i>Dollars</i>
Gold bullion and gold certificates	2,422,000	1,375,980	1,258,348	1,106,265	696,620	9,643,470	21,619,028
Clearing-house certificates (gold certificates)	8,775,730	8,775,730	7,035,240	7,528,355	5,390,420	1,625,550	166,616,370
United States notes			1,005,000	1,655,000		2,290,000	42,430,000
Clearing-house certificates (legal-tender notes)	17,000	25,000		20,000	23,000		295,500
Total gold	36,539,350	10,176,690	9,358,588	10,300,620	6,110,040	13,557,120	270,960,868
Silver coin	44,200				34,843	5	428,348
Silver certificates	392,867	413,172	2,911	535	80,145	28,013	6,340,469
United States notes							
Clearing-house certificates (silver certificates)							4,680,000
Total silver	437,067	413,172	2,911	535	114,988	28,013	11,448,517
National-bank notes	80,000		4,490		1,040	40	527,400
Legal tender notes	1,794,000	978,500	12,985	472,505	51,060	37,629	12,996,699
Clearing-house certificates (legal-tender notes)							
Total legal tender	1,794,000	978,500	12,985	472,505	51,060	37,629	20,525,699
Grand total	38,860,417	11,568,362	9,378,964	10,782,680	6,272,128	13,622,507	283,462,814
Per cent of gold	94 1	88 0	90 8	86 6	97 4	99 5	87 7

Disturbance Avoided

The object sought had been, moreover, not only that of obtaining a large payment in gold, but also of obtaining this payment with as little shock or disturbance to business as possible. The time selected proved to be peculiarly opportune for the accomplishment of this purpose. As noted in connection with the description of the act itself, the provisions of the new law permitted a very material reduction in the gross amount of reserves to be carried. This had been done for the twofold reason that it was believed that a strong central banking reserve in each district would be a much more powerful protection against the demands of depositors than a much larger reserve in the hands of scattered banks throughout the region, while it had also been felt that inasmuch as eventually the banks throughout the country would lose the interest which they had habitually received from city banks on their reserve balances, it was but fair to make some offsetting compensation to these out-of-town banks by permitting them to release a part of their funds, if they could safely do so, and thereby to obtain the means of making additional earnings designed to take the place of those which were lost through the cessation of the interest payments. Because of this reduction in required reserves, the banks of the country, as soon as the Federal Reserve Act went into actual operation, would in any case have been in an exceptionally easy position. While it was true that they were called upon to make a large transfer of cash to federal reserve banks, this cash constituted only a fraction of a total reserve which was materially less than that which they had previously carried, so that their aggregate lending power, if they chose to exert it, was considerably greater than before with reference to the reserve balances of which they stood possessed. This fact, of course, had nothing to do with the earning power of the bank, and the net position of any given institution from the dividend standpoint might be better or worse at the end of the first six months under the Federal Reserve Act, than

it had been during the last six months preceding the date when the law took effect, according as the institution was ably or unskilfully managed

Earning Position Irrelevant

Its earning power had nothing for the moment to do with its relation to business or its capacity to comply with the terms of the new legislation. The truth of the matter was that even under ordinary conditions, the average national bank could not only meet the requirements of the first instalment to be transferred to the federal reserve banks, but after paying such instalment would find itself with an increased lending power. Not only was there thus a large release of reserve and increase of lending power, but, as it happened, the banks found themselves at the time of the organization of the reserve institutions faced by a sudden decline of demand for loans. Business had heavily fallen off immediately after the opening of the European war. Both exportation and importation had been seriously interfered with, while domestic manufacturing was partly quiescent and partly preparing for the transition to the war industry basis which afterward so completely transformed it. From most standpoints there could probably not have been chosen a time when the process of shifting the reserves could have been more easily and more effectively carried out than the months of November and December, 1914. It was well that the transfer was effected at a moment of monetary ease. Pessimistic critics of the Federal Reserve Act had consistently predicted that the transfer of the reserves would almost shipwreck the banking system of the nation, and it had been their view that even the first transfer would at least cause a temporary stringency of alarming character. In the circumstances which then existed nothing of the kind was to be looked for, if there had ever been the slightest basis for it, and in fact, as already stated, the transfer took place on November 16 without the least interference with the natural course of

events. Indeed, had the fact of the transfer not been mentioned in the press or otherwise, it is doubtful whether there would have been any external indications of what was occurring.

Revulsion of Feeling

So unmistakably easy and innocuous was the process that even certain members of the Federal Reserve Board, who had previously feared the effect of the transfer, now regretted that it could not have been for a larger amount—recognizing as they did that even a much larger amount would, in consequence of the circumstances of the time, have been transferred without causing a ripple on the surface of the money market. The stock exchange indeed had already closed its doors, due to the “war panic,” but even had it continued open with a brisk market for shares and securities, there is little or no reason to suppose that the transfer of the first reserve instalment would have been different from what it was. In short, from November 16 onward, a triple reserve system had practically been put into operation, including as it did reserve in the vaults of banks, balances with their correspondents in specified cities, and required balances with federal reserve banks.

The only difficulty in the situation was really the reverse of that which had been predicted. So easy was the money market and so slender was the demand for loans, that it became apparent almost at the start that federal reserve banks would find it difficult to get any considerable amount of discounts unless they were willing to compete actively and directly with member banks. This policy, as elsewhere seen, they were, however, extremely reluctant to pursue. Accordingly, the cash in federal reserve banks tended for a good while to equal practically their liabilities—or in other words, it was many months before the reserve percentage of reserve banks fell much below 100 per cent. At times, indeed, it was in excess of 100 per cent of deposits, because both capital and reserve had been

paid in cash, while the outstanding deposits represented simply the reserve credits thus established. The reserve banks in these circumstances were not banks in the true sense of the term, but banking warehouses, providing safekeeping for a certain amount of coin belonging to the members. Reasons why the operations of reserve banks continued upon so low a level have been furnished elsewhere. In this place it is enough to note from the reserve standpoint that discount business was extremely slow in developing.

Reluctance to Shift Funds

The situation at the reserve banks and the conditions attending the first transfer of reserves had been watched by reserve city bankers with a morbid eye. It was a cardinal article of faith with bankers, both of reserve and central reserve cities, that they derived a very material advantage from the deposits of out-of-town correspondents. Their faith in this respect was plainly indicated by works, since they had for years past been competing with one another in various more or less indirect ways for the purpose of accumulating these deposits. No phase of the new legislation had so taken them by surprise and none had been so bitterly resisted when they became alive to its implications, as those clauses in the Reserve Act providing for the transfer of member bank reserves. It was on this point that the threats to leave the system had been most numerous, and it is probable that in some cases these threats had originally been voiced with more or less of conviction, although not with a sufficient degree of such conviction as to take any of the banks out of the system. Although obliged to recognize that the transfer of the first instalment of reserves had not produced the dangerous results that were expected of it, reserve city bankers nevertheless determined to make another effort to maintain the old system.

It has been seen that during the progress of the Federal Reserve Act through the House, central reserve city bankers

had attempted to arrange a "deal" whereby the power to determine whether balances in specified cities could count as reserve, should be vested in the Federal Reserve Board. Their purpose in this proposed deal had been to secure at last an opening which might be availed of for the purpose of bringing about an administrative ruling in their favor. This, as we have seen, had been defeated in part through the bankers' own decision to contest the reserve provisions of the new law in the belief that they could defeat them entirely.

New Plan of Anti-Reserve Campaign

After the transfer of the first reserve instalment, a different attack had necessarily to be followed. Consultations of bankers in various places developed the following plan of campaign:

- 1 Delay the introduction of the collection system as long as possible in order to have it appear that balances must be maintained in cities under the old system, and thus provide a basis for collection
- 2 Argue from this necessary continuance of balances that such balances ought not to be simply "dead" but that they should be allowed to count as reserves since the banks must hold them idle

Almost unlimited argument along these lines was directed to the Federal Reserve Board during the early days of the system, and immense amounts of discussion on the subject appeared in the press, but apparently without influencing the Board or members of Congress who were requested to take a hand in bringing about the change of policy. Accordingly, it was determined by reserve city bankers to do their utmost to secure permission to establish a "regional" system of redeposited reserve. They now resolved to abandon the argument in behalf of power to redeposit reserve in any part of the United States that they saw fit, and to substitute for it a demand that each community be permitted to retain its own

funds by redepositing these funds in neighboring cities. Late in the winter of 1914-1915, a delegation of reserve city bankers appeared at Washington and presented argument before the Federal Reserve Board in behalf of a discontinuance of the reserve transfer process, accompanied by a substitution of provisions authorizing the redepositing of reserves in any reserve city within 300 miles of the bank desiring to make such deposit. This plan, if adopted, would have placed each existing reserve city at the center of a theoretical circle, 600 miles in diameter, within which any bank might, if it chose, deposit with it. As 600 miles was a considerable distance, it would often have occurred that a number of reserve cities would lie within the circumference of one of these circles. The proposed division of the country, therefore, would have been based upon organization within a series of overlapping zones or circles, the banks being permitted to shift within the maximum limit of 300 miles from one zone to another. A modification of this plan was the suggestion that all banks situated outside of the twelve federal reserve cities might be permitted to deposit their reserves with the banks in these cities, which in turn, of course, would have to deposit the necessary percentage with the federal reserve banks. Neither of these plans had the slightest merit. They were practically destitute of any supporting argument and the Federal Reserve Board devoted only desultory and sporadic discussion to the suggestions that had been made.

Failure of Opposition

Within a month after the meeting at Washington, most of the reserve city bankers were quite well convinced that the attack upon the reserve transfer system had again failed and that if they expected any relief they would be obliged to look elsewhere. The country, however, was becoming more and more absorbed in the course of the European war and financial or banking questions received only very limited attention.

Moreover, as the months passed the federal reserve system had succeeded in commending itself in the main to the less partisan and less biased observers, both in Congress and out of it. The predictions of disaster and ruin to follow the transfer of reserves accordingly received but little attention, and the date for the second instalment payment arrived on November 16, 1915, and was passed without causing the slightest disturbance to market conditions. The second instalment, like its predecessor, had amounted to approximately one-twelfth to one-fifteenth of required reserves, and although computations were again partially vitiated by the existing system of pyramiding reserves, the second payment resulted in a transfer of rather more gold than on the first occasion so that at the close of the year 1915, when the system had been technically in existence for about fourteen months, but actually for only thirteen and a half months, subject to the first and second reserve payments and not more than eleven or twelve months from effective organization, the gross gold holding of the reserve banks amounted to \$345,000,000.

This second payment, as just intimated, had received, if anything, less attention than its predecessor, although for entirely different reasons. Money market conditions were still easy, and abundance of lending power existed in the hands of the member banks without any recourse to rediscounting. There had set in, however, an enormous movement of actual gold toward the United States. This movement had begun about the end of the first quarter of 1915, and its first result was to create an immense surplus of cash reserve. Had it not been for this movement of cash into the banks of the United States, some rediscounting might have been necessary in order to bring about the successful transfer of the second instalment. As it was, the transfer of the reserves in gold had no relation to the situation because of the already unduly increased reserve percentages which had resulted from the heavy net gold import movement.

CHAPTER XXX

ORGANIZING THE FEDERAL RESERVE BOARD

Theory of the Act

The Federal Reserve Act had provided for the choice of a Governor and a Vice-Governor of the Federal Reserve Board, but it had not specified their terms of office and it had left their selection to the President. This was not the result of accident. The question how these officers should be chosen or designated and what they should do had been actively debated from the very beginning. Certain conclusions had been reached as follows

- 1 The Secretary of the Treasury is too much busied with his own duties to act steadily and efficiently as the head of the Board
- 2 The actual executive of the Board should therefore be chosen from among the appointive members and should be given important operating functions
- 3 Experience with other boards which chose their own heads not having been happy, the better plan is that of leaving the designation to the President
4. The qualities and abilities of the new members being in doubt at the outset, the plan to be preferred will be that of leaving the situation flexible, enabling the President to change or modify it if conditions demand

Out of these general conclusions came the decision to adopt the section relating to the organization of the Board as originally formulated. It was altered but little in the progress through the two houses, and as finally passed stood as follows.

SEC 10 A Federal Reserve Board is hereby created which shall

consist of seven members, including the Secretary of the Treasury and the Comptroller of the Currency, who shall be members *ex officio*, and five members appointed by the President of the United States, by and with the advice and consent of the Senate. In selecting the five appointive members of the Federal Reserve Board, not more than one of whom shall be selected from any one Federal reserve district, the President shall have due regard to a fair representation of the different commercial, industrial and geographical divisions of the country. The five members of the Federal Reserve Board appointed by the President and confirmed as aforesaid shall devote their entire time to the business of the Federal Reserve Board and shall each receive an annual salary of \$12,000, payable monthly, together with actual necessary traveling expenses, and the Comptroller of the Currency, as *ex officio* member of the Federal Reserve Board, shall in addition to the salary now paid him as Comptroller of the Currency receive the sum of \$7,000 annually for his services as a member of said board.

The members of said board, the Secretary of the Treasury, the Assistant Secretaries of the Treasury, and the Comptroller of the Currency shall be ineligible during the time they are in office and for two years thereafter to hold any office, position or employment in any member bank. Of the five members thus appointed by the President at least two shall be persons experienced in banking or finance. One shall be designated by the President to serve for two, one for four, one for six, one for eight, and one for ten years, and thereafter each member so appointed shall serve for a term of ten years unless sooner removed for cause by the President. Of the five persons thus appointed, one shall be designated by the President as governor and one as vice governor of the Federal Reserve Board. The governor of the Federal Reserve Board, subject to its supervision, shall be the active executive officer. The Secretary of the Treasury may assign offices in the Department of the Treasury for the use of the Federal Reserve Board. Each member of the Federal Reserve Board shall within fifteen days after notice of appointment make and subscribe to the oath of office.

The Federal Reserve Board shall have power to levy semiannually upon the Federal reserve banks, in proportion to their capital stock and surplus, an assessment sufficient to pay its estimated expenses and the salaries of its members and employees for the half year succeeding the levying of such assessment, together with any deficit carried forward from the preceding half year.

The first meeting of the Federal Reserve Board shall be held in Washington, District of Columbia, as soon as may be after the passage of this act, at a date to be fixed by the Reserve Bank Organization Committee. The Secretary of the Treasury shall be ex officio chairman of the Federal Reserve Board. No member of the Federal Reserve Board shall be an officer or director of any bank, banking institution, trust company, or Federal reserve bank nor hold stock in any bank, banking institution, or trust company, and before entering upon his duties as a member of the Federal Reserve Board he shall certify under oath to the Secretary of the Treasury that he has complied with this requirement. Whenever a vacancy shall occur, other than by expiration of term, among the five members of the Federal Reserve Board appointed by the President, as above provided, a successor shall be appointed by the President, with the advice and consent of the Senate, to fill such vacancy, and when appointed he shall hold office for the unexpired term of the member whose place he is selected to fill.

The President shall have power to fill all vacancies that may happen on the Federal Reserve Board during the recess of the Senate, by granting commissions which shall expire thirty days after the next session of the Senate convenes.

Nothing in this act contained shall be construed as taking away any powers heretofore vested by law in the Secretary of the Treasury which relate to the supervision, management, and control of the Treasury Department and bureaus under such department, and whenever any power vested by this act in the Federal Reserve Board or the Federal reserve agent appears to conflict with the powers of the Secretary of the Treasury, such powers shall be exercised subject to the supervision and control of the Secretary.

The Federal Reserve Board shall annually make a full report of its operations to the Speaker of the House of Representatives, who shall cause the same to be printed for the information of the Congress.

Section three hundred and twenty-four of the Revised Statutes of the United States shall be amended so as to read as follows: There shall be in the Department of the Treasury a bureau charged with the execution of all laws passed by Congress relating to the issue and regulation of national currency secured by United States bonds and, under the general supervision of the Federal Reserve Board, of all Federal reserve notes, the chief officer of which bureau shall be called the Comptroller of the Currency and shall perform his duties under the general directions of the Secretary of the Treasury.

Designation of First Governor

President Wilson accordingly found it needful to designate a member of the Board as Governor and did so, naming Mr C S Hamlin, while in like manner he named F A Delano as Vice-Governor

Mr Hamlin thus became the first Governor and (in the absence of the Secretary of the Treasury) the presiding officer of the Federal Reserve Board, and he continued for two years in that capacity The choice was wise Many of the more difficult problems to be met by the Board at the outset were those of personal relationship, choices of men, settlement of organization questions Mr Hamlin was essentially a diplomat in the best sense of the word, tactful, gracious, and considerate of the feelings and opinions of his associates He was thus peculiarly well qualified for the first problems that grew out of Reserve Board organization

Mr Hamlin had a distinct theory of the functions and organization of the new Board His was an essentially legalistic mind and a study of the act convinced him that the law had been framed upon definite and distinct lines of theory He believed that the Board was a group of equally influential members who were called upon to assume the responsibility and to share the work accruing to the group as a whole From the first, therefore, Mr Hamlin's administration made it a point to bring officially to the attention of the Board every item of business that had any significance and even many that were of routine importance only and to obtain definite instructions as to their disposal

Policy of Management

The policy thus pursued by Mr Hamlin was not, however, acceptable to other members Some of them resented the necessity of long routine discussions on details Others objected to the confinement and attention to business involved in the actual discussion and disposal of details Still others,

willing and ready to work, felt that the plan pursued involved too great delay and was not sufficiently "businesslike." The first plan of organization as finally evolved had necessitated the naming of a number of committees on which (as the total number of members was small) each member had to serve in more than one capacity. This necessitated many meetings and thorough consideration of every action both in committee and before the Board as a whole. The work was onerous and the members found it disagreeable.

Nevertheless the plan of organization which had been devised by Mr. Hamlin practically perpetuated itself during the first two years of the Board's life. This carried the organization to August, 1916, at which time it was determined to change the Governorship. Mr. Hamlin had in the meantime been redesignated for one year, his first term of office having lasted but a single year as Governor. Inasmuch as Mr. Hamlin had himself drawn the short membership term (two years) in the assignment of the first places in the Board, it was necessary to reappoint him and obtain his confirmation from the Senate, and this was accomplished in the summer of 1916. At the same time he was advised that the President had determined to make a change in the Governorship and he was succeeded by Mr. Harding who continued to hold the office up to expiration of his own term in the summer of 1922.

Change in Organization

This change of personnel brought with it a great change in the organization of the Board. It was not the result of accident but grew out of the formation of a cabal within the Board which was dissatisfied with the older system and with Mr. Hamlin's management of affairs. It was the object of this cabal to secure the designation of Mr. P. M. Warburg as Governor, but the opposition to the proposed change succeeded in shifting the choice of the new Governor to Mr. Harding. Mr. Warburg, however, was designated as Vice-

Governor, succeeding Mr. Delano, and continued to hold the Vice-Governorship up to the end of his term of office in 1918. Those who had sought to engineer the change of management in 1916 had not, however, thought of it purely as a matter of change in personnel. The complaint was brought against Mr. Hamlin's management that it was not sufficiently prompt and that it resulted in too great a dispersion of function throughout the membership of the Board with corresponding "loss of motion" and "unbusinesslike" conditions in the treatment of current affairs. One of the first steps of Governor Harding upon taking office was therefore to bring about a very considerable alteration of committee assignments and particularly the vesting of large powers in a small Executive Committee, which was authorized to hold meetings whenever necessary and to take action along specified lines, reporting the same to the Board in the form of minutes which, when duly approved, made the action of the Executive Committee the action of the Board itself. Thus, at times, degenerated into so-called "constructive meetings" of the Executive Committee, in which minutes were prepared by the Secretary of the Board indicating action of a specified kind, and were then presented to individual members of the Committee for initialing, the result being the theoretical holding of a committee meeting which, however, had never actually taken place. The principal idea of the new Harding administration in executive management was that of operating the Board "like a bank," and this was more and more nearly possible because of the fact that with the gradual approach of war, and later with the actual advent of war itself, the Secretary of the Treasury, the titular chairman of the Board, took a smaller and smaller part in affairs and attended meetings with less and less frequency. Thus it may fairly be said that during the administration of Governor Harding, there was a strong tendency towards the centralization of executive business in the Governor's office and an equally strong tendency to concentration of the powers

of the Board in the hands of the Governor. The Board itself at times appeared to be merely a consultative organization or a body possessed of the veto power, the actual initiating of business and the carrying through of policies being left in the hands of the Governor or, at times, of the Governor and Vice-Governor jointly. This may perhaps have been in considerable degree accentuated by the urgent exigencies of war. It was at all events the characteristic type of organization from and after the first two years of the Board's life. It implied a great change in the character of the relations between the Board itself and the several reserve banks, as well as in the relationships between members of the Board themselves.

Method of Appointing Directors

It seems appropriate at this point to refer, as a feature of the early organization of the Reserve Board, to the practice developed during its first days of existence with respect to appointments. At the outset, the responsibility rested upon the Board of selecting three government directors (one the chairman) at each of the twelve federal reserve banks, while it was inevitable that during the organization stages the reserve banks themselves should be inclined to consult quite freely with the Board or its individual members with regard to the choice of their staffs. There were thus a large number of valuable appointments to be distributed, and question early arose as to methods to be adopted in choosing or passing upon candidates. An informal understanding was developed whereby the senatorial practice of leaving to each member the verdict concerning appointments in his own and (so far as necessary) neighboring or adjoining districts was accepted by the Board, and accordingly a division of districts was made, roughly corresponding to the portions of the country from which the different members were drawn. Needless to say, this informal division was not always strictly adhered to, nor was the report of a member of the Board with respect to a

given candidate in one of his districts always regarded as final, although it might be described as at least first evidence in favor of the candidate in question or the policy recommended—in so far, of course, as either could be considered to be purely local. This policy was undoubtedly injurious, indeed might almost have been considered disastrous. It could be defended only on the ground that some very prompt work was called for in setting the system on foot, and that this was one means of covering the necessary ground with as little delay as possible. Such a defense, of course, could hold good only with respect to the earliest appointments and policies and could not be urged as regards those of later date.

Plan of Supervision

Closely allied with the question of appointments thus disposed of, was also to be noted the policy adopted with respect to supervision of the several districts. This closely followed the appointment policy, each member of the Board being at the outset required to exercise a certain supervision over occurrences within his district or districts. Literal fulfilment of such a mandate would have required extensive travel on the part of those who were in charge of the more distant districts, but members soon found it either impracticable or unattractive to spend much of their time in travel to and fro between Washington and the several districts under their charge. As things eventually developed, much of this supervisory work was left to the staff of examiners, although from time to time special visitations were made by members of the Board or occasionally by others of its officers or employees for the purpose of ascertaining facts or conveying the views of the organization. How successful this method may be considered to have been will more clearly appear later. At this point it is sufficient merely to call attention to the method adopted and to note its obviously inherent defects.

Relation to Treasury

There was another problem of organization which from the very beginning received the anxious attention of the members of the Board but which never was finally settled; and was, throughout the whole history of the enterprise, the source of greatest trouble and confusion. This doubt was found in connection with the relation of the Board to the Treasury Department. Although the act itself had contemplated the question what should be the character of this relationship and had sought to define it with some care, it was impossible to reach a positive conclusion as to all details. This was partly due to the jealous attitude adopted by the Treasury officials during the discussion in committee and in Congress. But it was also partly due to the fact that there could be no absolute forecasts of the problems which must be encountered by the new organization. The act, for example, had made no specific provision with regard to the quarters to be occupied by the Board, and one of the earliest questions to be settled was whether the new organization could accept rooms in the Treasury Department or not. Another phase of the same question was seen in connection with accounting. The Board was authorized to levy large sums upon the reserve banks, and it was recognized from the beginning that this might be a source of scandal should there be the slightest laxity or carelessness. Hence arose the question. Was the Board subject to government accountancy supervision? Must it guide itself as to outlay for traveling and other expenses by government rules, inflexible and at times unfair as these were? These and other allied questions soon forced upon the Board the necessity of getting from the Attorney-General an opinion regarding its true position and such an opinion was rendered on December 19, 1914.

Opinion of Attorney-General

The opinion, as handed down, set at rest some questions relative to the status of the organization and proved to be of

fundamental importance in connection with its later history. The Board was described as an "independent bureau or establishment of the Government," and as such obviously was not under the jurisdiction of the Treasury Department. While the language employed by the Attorney-General in his decision did not expressly require that the Board should subject itself and its doings to government audit and examinations, it evidently contemplated that type of supervision, its funds being "public moneys", and an opinion of the solicitor of the Treasury rendered at about the same time did clearly contemplate such a situation. This might have been contested and for a moment some members of the Board thought of resisting. It had been the opinion of some members that a semiannual or quarterly audit of the Board's accounts made by an accountancy firm of known reputation and published, would have been quite as valuable and would have served as fully as effective a check upon undesirable tendencies as would the regular oversight of the government accountants. But in this the influence of the Treasury Department was sufficient to leave matters as they had been adjusted by the Solicitor of the Treasury, and in consequence the Board fell into the practice of pursuing government methods of bidding, paying out moneys, certifying, auditing, and generally of managing its own financial affairs. In some ways, the decision thus reached was wise as a matter of expediency, and doubtless tended to protect the Board against later criticism of a political nature, but in other ways the decision was injurious. The worst effect of it was found in the fact that it tended more and more to give the Board the character of a regular routine bureau or office organized and operated like other government bureaus.

An Unhappy Guest

At the time of the Board's organization the Treasury Department was very crowded. Secretary McAdoo, however, was determined to have the Board located within the walls of

the main Treasury building and, at considerable expense and annoyance, he succeeded in clearing a part of one floor in the west wing of the Treasury for use as offices. The Board found the offices incomplete, inadequate, and inconvenient. Yet, although an unhappy guest of the Department, it did not dare to move. During the first year or two of its tenancy of the rooms in the Treasury, there was constant complaint on the part of members and from time to time a proposal to take quarters in some other building. One member of the Board even called attention to the fact that there was nothing in the act compelling the retention of the head office at Washington and proposed that it be moved to Chicago. Such a course would have effectually prevented the Secretary of the Treasury from attending any of the meetings and the suggestion was never very seriously urged. In later years, the desire for adequate quarters led to various proposals that the Board itself move into another building but the nearest approach to such policy was seen in the leasing of outside rooms for the Board's own staff, all of its various departments and offices being eventually consolidated in one structure at some distance from the Treasury. The organization itself never had the courage to act upon its own instincts, and the result was that as time passed it gradually became more and more dependent upon Treasury dictation and less and less able to assert itself independent of the Treasury authorities. This was perhaps the most fundamental error in the process of organization, since it forever condemned the Board to a position of subordination and definitely established it as in fact, even if not in theory, a portion of the organization of the Department.

Social Status of Board

The position thus assigned it was somewhat emphasized by what would ordinarily have been regarded elsewhere than in Washington as an amusing piece of byplay or official snobbery. Soon after the organization of the Board, the social

authorities of the State Department were called upon to determine the "status" of members at official receptions, dinners, and the like. They determined that members of the Board must enter dining-rooms after Assistant Secretaries of the Treasury and after Assistant Secretaries of other departments of the government, thus placing them substantially upon the same sort of basis as the Interstate Commerce Commission and other similar bodies which had always had a notoriously unsatisfactory position in official society. The decision was conveyed to the Board by the Secretary of the Treasury with somewhat sardonic humor and was a subject of considerable debate. Eventually, the Board decided not to accept the social status assigned to it and thus never obtained any definite position in that regard. But the harm had been done and in an atmosphere like that of Washington the effect of such a decision in impairing the morale of the organization made up as was the Board was considerable. The incident would be unworthy of notice in and of itself, but in its indirect financial effects it had a significance that might perhaps otherwise escape attention. The notion of "a Supreme Court of Finance" which had been carefully fostered in many quarters and had been accepted with pleasure by the new appointees, was thus given a severe blow, and, taken in conjunction with other influential factors some of which have already been reviewed, this blow tended to impair very greatly the feeling of independence and freedom from subordination to political authorities which it had been hoped to develop.

Internal Organization

Reference has been made at an earlier point to the fact that the Board had, as an early official act, selected a Secretary whose duty it was to conduct the general executive business of the Board subject to the direction of the Governor, while his supplementary function was to oversee the Board's scientific work and provide such data as might be required for the inves-

tigations and studies of the organization. The by-laws of the Board gave to the Secretary's office a considerable scope of authority, and the early practice of the organization required the presence of the Secretary at all meetings. With the Secretary was associated an Assistant Secretary who was given charge of the office management, and who succeeded the Secretary in charge of general business in the absence of the latter, while a counsel (subsequently called General Counsel) was entrusted with the management of the Board's affairs and the rendering of opinions. A statistician, with a small corps of assistants, was of course an early necessity, and to him was given supervision of the reports and public statements of condition of reserve banks. A chief examiner was shortly appointed, with instructions to examine into conditions at reserve banks practically at quarterly intervals, later at approximately half-yearly intervals, and he was directed to build up a staff of examiners. At a later date the duties of the statistician were divided, supervision of reports and auditing being given to a new and independent division, the old one being confined to statistical work pure and simple, while a division of analysis and research established in 1918 was given charge of the Board's scientific work, its investigations into banking questions, its function of business reporting, developed in 1918, and various other duties.

Board's Report on Organization

In describing its action regarding the development of an administrative staff, the Board at the close of 1914, reported in summary form as follows ¹

In organizing its staff the Board has sought to observe economy and to keep the personnel within the narrowest limits consistent with efficiency. The Reserve Bank Organization Committee had established a staff of about 75 persons, and the Board determined to take over as a nucleus of its own force such members of this staff as were

¹First Annual Report, Federal Reserve Board

deemed necessary for the conduct of its work. After careful investigation, a total of about 40 persons were thus transferred and given a permanent status in the Board's organization. There had been many applicants for appointments to the staff of the Board, the total aggregating more than 1,200, and in order to give applicants in places distant from Washington an equal opportunity and provide fairly for a distribution of such appointments as might later be made, an examination conducted (on a basis prescribed by the Board) by the Civil Service Commission was given on behalf of the Board on December 9. Returns from this examination had not been received up to December 31, but future appointments will be made from the list of eligible persons established as a result of this examination, save in so far as there may be a need for officers of highly special or technical attainment.

As at present organized the Board's staff comprises four divisions—one dealing with correspondence, one with bank audit and examination, one with reports and statistics and a law department in charge of a general Counsel. The Board has appointed two administrative officers, to be known as Secretary and Assistant Secretary, and has appointed to these positions, respectively, H. Parker Willis, as the former, and Sherman P. Allen, as the latter. The general management of the staff of the Board is under the direction of the Secretary's office. The Board appointed as counsel M. C. Elliott, previously the Counsel of the Organization Committee. Apart from the Correspondence Division, the name of which sufficiently indicates the nature of its duties, the Board's work is now carried on by the Division of Audit and Examination and the Division of Reports and Statistics.

Character of Organization

The character of the organization which had thus been effected on behalf of the Federal Reserve Board, was destined to be of considerably more importance than was at first believed. The Board had, in the first instance, undoubtedly organized its staff upon a basis of unusual economy. This was true no matter whether the situation be considered absolutely or as a matter of comparison with other government commissions and administrative bodies. For the year 1915 the total amount paid out by the Board was only about \$200,000. During the war years this amount was greatly increased because

of the fact that new duties connected with the control of foreign exchange and the movement of gold were laid upon the Board, although they really had no relation to its functions. When the war was over and it had been relieved of these duties, its expenses were restored to somewhat their former level and it may be asserted without question that throughout its whole history the administrative organization in Washington has been conducted upon a narrowly economical basis without supernumeraries and with salaries closely adjusted to the general level of government salaries. Considering the amount of work done and the quality which was necessarily required in it, the cost of central supervision has thus been remarkably low. Taking, for example, such a function as the management of the gold settlement fund, it is found that the cost of transferring \$74,000,000,000 in this fund was, during the year 1919, only \$250,000. Not even the severe critics of the system in Congress have ever suggested that there had been nepotism or favoritism or political influence or extravagance in connection with the central organization.

Efficiency of System

A much less favorable estimate of what the Board did in perfecting its own organization must be afforded when we consider that organization from the standpoint of efficiency in the larger sense. Partly because of the constant effort to retain its staff at a very low cost figure, and partly because of the unwillingness on the part of some members of the organization to commit to subordinates duties which should have been placed in their hands, thereby leaving the members themselves entirely free, the staff of the Board never attained a complete or fully organized status. Refusal to employ the best experts or to give those in the service of the Board the time necessary to devote themselves to detailed studies of the problems before the Board, have often resulted in unfinished work. The Board has undoubtedly always been understaffed and not

sufficiently expertly staffed. Perhaps there would have been no very great hardship in this situation had the members of the Board themselves been more permanent in tenure of office, but it speedily appeared that they were anything but firmly fixed in their offices, and, as has already been seen at an earlier point, the first eight years of the Board's history resulted in many changes, not all of them for the better. The effect has been to cause a changing and shifting membership in the Board itself and to prevent the maintenance of a uniform standard of efficiency in the work done by the members. This same insecurity of tenure has always affected the members of the Board's staff. The Secretaryship of the Board was in the first eight years held by four successive incumbents, while many more changes were made in the Assistant Secretaryship. The counsel of the Board has been changed four times, and the assistant counsel at least as many. The examination staff has been in a condition of frequent change, sometimes almost of disorganization. Instead, therefore, of a highly expert specialized staff of men practically permanent in tenure and entirely capable of carrying on the work of the organization, even if the entire membership of the Board itself should be suddenly unable to attend to duty, the organization of the Federal Reserve Board has at times been almost on the verge of breakdown. Changes in personnel have been rendered more serious as the result of changes in method. Refusal to divide the work among a number of officers in order to get it efficiently and expertly done, desire on the part of all members of the Board to see and approve practically everything that was sent out, the necessity from time to time of sending even routine correspondence in folders from office to office in order that carbons of the more important letters might bear the "O K" of all members, have been partly the product of mutual suspicion and partly the result of insufficient activity on the part of the membership. The concept originally entertained of the Federal Reserve Board as a "Supreme Court of

Finance," its members devoting themselves steadily to study and action upon abstract financial problems, was feasible only in the event that the membership of the Board itself was willing and capable of acting like a supreme court of finance. Such action would have been possible only in the event of the development of a strong supporting expert organization to which should be committed the entire routine of operation. This has never been done. The responsibility for the failure to do it does not rest upon any one individual but is a joint responsibility, its effects, however, being none the less of far-reaching significance.

Difficulty of Relation with Federal Reserve Banks

An extremely weak element in the Board's method of organization, already briefly referred to, was found from the beginning in its lack of direct relationship with the federal reserve banks. The membership, as elsewhere seen, was never inclined to devote the time necessary to constant travel for the purpose of visiting the different banks, and perhaps could not have been expected to do so. It, however, never retained permanently in its service inspectors whose duty it should be to make rounds regularly and to report on special local conditions. This function could not be and was not performed by the examination staff except in a very remote and unsatisfactory way. Neither could it be performed by the Secretary of the Board who from the beginning was occupied with many phases of administrative work at Washington. At one time an assistant to the Governor was appointed and during the period of his incumbency it was possible at least to send either him or the Secretary of the Board upon such tours of inquiry and some little work was done in this way. From time to time, members of the Board, either singly or in groups, have visited the reserve banks for the purpose of making some specific investigation, but the work has undoubtedly been sporadic and the result of the situation has been to establish only an inade-

quate means of understanding and co-operation between the central institution and the local branches. This during the earlier years was the more regrettable because of the presence of many problems of organization which, although general in their essential nature, assumed a very special form locally. What these were will be detailed more at length in another chapter.

APPENDIX TO CHAPTER XXX

STATUS OF FEDERAL RESERVE BOARD—AN OPINION RENDERED BY ATTORNEY GENERAL

OFFICE OF THE ATTORNEY GENERAL,
Washington, D. C.

The honorable the Secretary of the Treasury,
Washington, D. C.

SIR: I have the honor to acknowledge your letter of October 29, 1914, wherein you request my opinion (a) whether accounts of moneys derived from the semiannual assessment to be levied on Federal reserve banks by the Federal Reserve Board are subject to audit by one of the auditors of the Treasury Department, and (b) as to the status of the Federal Reserve Board, particularly with reference to the Treasury Department.

Section 10 of the "Federal reserve act" of December 23, 1913 (the act authorizing the assessment), provides

"The Federal Reserve Board shall have power to levy semiannually upon the Federal reserve banks, in proportion to their capital stock and surplus, an assessment sufficient to pay its estimated expenses and the salaries of its members and employees for the half year succeeding the levy of such assessment, together with any deficit carried forward from the preceding half year."

The answer to your first question depends on whether the moneys so levied by the Federal Reserve Board are, when received, "public moneys." If so, they are clearly to be audited under sections 7 and 10 of the act of July 31, 1894 (28 Stat., 207), either by the auditor provided for in the first paragraph of said section 7 or by the auditor provided in the fifth paragraph, such paragraphs (so far as material) reading as follows:

First "The Auditor for the Treasury Department shall receive and

examine all accounts of salaries and incidental expenses of the office of the Secretary of the Treasury and all bureaus and offices under his direction, all accounts relating to and all other business within the jurisdiction of the Department of the Treasury and certify the balances arising thereon to the Division of Bookkeeping and Warrants "

Fifth "The Auditor for the State and other departments shall receive and examine all accounts of and accounts of all boards, commissions, and establishments of the Government not within the jurisdiction of any of the Executive Departments He shall certify the balances arising thereon to the Division of Bookkeeping and Warrants "

Section 10 (so far as material) provides for a Division of Bookkeeping and Warrants, and that—

"Upon the books of this division shall be kept all accounts of receipts and expenditures of public money," etc

Reference is also to be made to the act of February 19, 1897 (29 Stat, 550), reading (so far as material) as follows

"All books, papers, and other matters relating to the office or accounts of commissions, boards, and establishments of the Government in the District of Columbia, shall at all times be subject to inspection and examination by the Comptroller of the Treasury and the Auditor of the Treasury authorized to settle such accounts, or by the duly authorized agents of either of said officials "

(This statute plainly applying to boards, etc, located within the District of Columbia, rather than to boards of the District government, and the Federal Reserve Board being located within the District)

I am of opinion that moneys received by the Federal Reserve Board, under section 10 of the act of December 23, 1913, are "public moneys" within the meaning of these auditing statutes, for the following reasons, among others

(1) The assessments are levied by a board whose members, in respect to appointment, tenure, duties, and compensation, meet all requirements of the definition "public officers" and "officers of the United States "

(2) The assessments are levied by such officers pursuant to the provision of a Federal statute and are devoted to the payment of official salaries and the expenses of this official board

(3) These moneys, after collection, are no longer the property of the paying banks, and must be viewed as moneys belonging to the United States, and therefore public moneys as defined by the Supreme Court of the United States in *Branch v United States*, 100 U S, 673

In *United States v Bromley*, 12 How, 88, it was held that postal collections from stamp sales are public revenues

"The revenue of the Post Office Department being raised by a tax on mailable matter conveyed in the mail and which is disbursed in the public service, is as much a part of the income of the Government as moneys collected for duties on imports"

The analogy is marked for the reason that in like manner as the money assessed by the Federal Reserve Board is for the special purpose of meeting the salaries and expenses of the board, so the use of the postal collections is confined to sustaining the specific service by and in which they are collected

(4) Other provisions of the Federal reserve act (secs 11-c and 16), dealing with the interest charges, taxes, and penalties, can only be satisfied by deposit in the Treasury of the levies, taxes, and penalties so imposed, and there seems to be no logical ground for distinction between such assessments and the ones in question. The idea of necessary public control is also strengthened by the requirements of Revised Statutes, section 3639

The moneys received by the Federal Reserve Board under section 10 of the act of December 23, 1913, being thus, in my opinion, public moneys, and consequently subject to audit by one of the auditors of the Treasury Department, the question is then directly presented under which paragraph of the act of July 31, 1894, *supra*, the audit is to be made. This involves the further question on which you have asked my opinion, namely, whether the Federal Reserve Board is an independent board, commission, or Government establishment, or whether it is a bureau, office, or division, or otherwise a part of the Treasury Department

That the Federal Reserve Board is a "board" or "establishment" of the Government within the meaning and intent of those words as used in the fifth paragraph of section 7 of the act of July 31, 1894, is plain from the provisions of the Federal reserve act and the explanation of the status of the board contained in the reports accompanying the original bills in Congress. This conclusion is sustained by reason and analogy when reference is had to the considerable number of boards or establishments of far less general or national scope which have been so esteemed and uniformly treated. (See Report of Joint Commission to Inquire into Executive Departments, Oct 9, 1893 House Reports, 1st sess 53d Cong, Report No 88)

Consideration of the history of the Federal reserve bank act, of the general scheme of the whole act, of the functions to be performed by the Federal Reserve Board, and of the method of their perform-

ance, leads me to the clear opinion that the board is an independent board or Government establishment

The Federal Reserve Board is not merely a supervisory, but is a distinctly administrative board with extensive powers. It is described as follows in the report of the Committee on Banking and Currency to the House of Representatives (63d Cong, 1st sess, Report No 69) .

Page 16. "In order that these banks may be effectively inspected and in order that they may pursue a banking policy which shall be uniform and harmonious for the country as a whole, the committee proposes a general board of management intrusted with the power to overlook and direct the general functions of the banks referred to To this it assigns the title of 'The Federal Reserve Board' "

Page 18 "The only factor of centralization which has been provided in the committee's plan is found in the Federal Reserve Board, which is to be a strictly Government organization created for the purpose of inspecting existing banking institutions and of regulating relationships between Federal reserve banks and between them and the Government itself "

Page 42 "Section 11 In this section provision has been made for the creation of a general board of control acting on behalf of the National Government . . . "

The report of Senator Owen from the Senate Committee on Banking and Currency (63d Cong, 1st sess, Report 133, part 2) says merely

"The Federal Reserve Board, consisting of the Secretary of the Treasury and six members appointed by the President of the United States and confirmed by the Senate for terms of six years, are given the following powers " (Here follows an enumeration of powers.)

The broad functions outlined in these reports are assigned to the board in 12 subdivisions of section 11 of the act giving to it certain powers and authority, and in various other sections containing specific grants of authority to exercise about 40 other powers Moreover, in subdivision (1) of section 11 the all-embracing requirement appears that "said board shall perform the duties, functions, or service specified in this act and make all rules and regulations necessary to enable said board effectively to perform the same "

The act further contains no express provision that the Federal Reserve Board shall be considered as a bureau, division, or office of the Treasury Department, a significant omission in view of the fact that Congress had under consideration a bureau of that department when, in section 16, it amended the Revised Statutes relative to that "bureau," of which the Comptroller of the Currency was the "chief

officer", and the provision in section 10 that "the Secretary of the Treasury may assign offices in the Department of the Treasury for the use of the Federal Reserve Board"—a provision added to the House bill by the Senate committee—would be highly superfluous if the board were a bureau of that department for which the Secretary already possessed complete authority to assign offices in his own departmental buildings

The history of the bill develops the following facts of significance

In section 11 of H R 7837 (sec 10 of the act), it is provided

"The manager of the Federal Reserve Board, subject to the supervision of the Secretary of the Treasury and Federal Reserve Board, shall be the executive officer of the Federal Reserve Board"

This clearly contemplated that the Secretary of the Treasury and the Federal Reserve Board were distinct entities.

In the act as passed (sec 10) the supervision of the Secretary of the Treasury is stricken out, leaving the governor (manager) subject only to supervision of the board

In section 16 of H R 7837 (sec 16 of the act) it is provided

"The Secretary of the Treasury shall, subject to the approval of the Federal Reserve Board, from time to time apportion the funds of the Government among the said Federal reserve banks, distributing them, as far as practicable, equitably between different sections"

This also clearly contemplated the Secretary and the board as coordinate officials. The whole provision was stricken from the act as passed, but nothing was substituted for it.

In section 11 of H R 7837 (sec 10 of the act) the Comptroller of the Currency was to perform his duties "under the general direction of the Secretary of the Treasury acting as chairman of the Federal Reserve Board"

In the act as passed the words "acting as chairman of the Federal Reserve Board" were stricken out, showing an intention to distinguish clearly between placing the comptroller under the Secretary as head of the Treasury Department and the Secretary as ex officio chairman of the board.

The most significant change made in H R 7837 by the act as passed was the insertion in section 10 of the act of the following clause

"Nothing in this act contained shall be construed as taking away any powers heretofore vested by law in the Secretary of the Treasury which relate to the supervision, management, and control of the Treasury Department and bureaus under such department, and wherever any power vested by this act in the Federal Reserve Board or the

Federal reserve agent appears to conflict with the powers of the Secretary of the Treasury such powers shall be exercised subject to the supervision and control of the Secretary "

It is evident that, while the purpose of this clause was, amongst other things, to insure the preservation and supremacy of all existing powers of the Secretary of the Treasury in all cases where it might be claimed that such powers overlapped or conflicted with those of the Federal Reserve Board, nevertheless by this very provision the act clearly recognized the existence of powers of the board independent of the Secretary in cases where no such conflict existed

Very respectfully,
(Signed) T W GREGORY,
Attorney General.

CHAPTER XXXI

ORGANIZATION PROBLEMS IN RESERVE BANKS

Status of Reserve Agent

As seen in an earlier chapter, the Organization Committee had finished its work by securing the technical incorporation of the federal reserve banks, while the member banks, which at that time were exclusively national institutions, had performed their share of the process of organization by electing six directors for each reserve bank. Thus, however, left to the Federal Reserve Board the duty of selecting three other directors, one of whom should be the chairman of the board at each federal reserve bank. The task was one for which the Board was on the whole not very well equipped and with respect to which it had no satisfactory body of data.

An important modifying factor in the situation was found in the circumstance that, of the three directors to be chosen by the Board, one was to be chairman and was to be a man of proven banking experience. The question naturally arose very early in the Board's deliberations, whether this chairman was to be in effect the real operating head of the bank or not. The Federal Reserve Act itself gives no indication on this subject but had intentionally left for later determination the entire question of the internal organization of the federal reserve banks. The Board, therefore, could obtain information as to the intent of the law only by discussing the situation with those who had been active in furthering it, and from them the members obtained a conviction that what had been

sought in framing the act was to provide thorough government oversight and control, but to leave to the member banks the actual task of operation, acting through such persons or agencies as they might deem best. In this view of the case the selection of the federal reserve agent was, however, a matter of still greater difficulty. If he was, in fact, not to be the operating head of the bank, it was still a fair question whether he was to be in a sense superior to the operating head—the real chief of the whole situation—or whether he was to be, as some supposed, merely the “agent” of the Board, exercising some clerical or routine functions under the direction of the latter. There could be no doubt that, if the latter view of the federal reserve agent’s functions were to be accepted, the choice of men for the place would be very much easier, and their salaries might readily be made much lower, whereas if the composition of the federal reserve agent’s duties should be that of actual management or oversight, a very different point of view would have to be adopted with respect to the qualities required and the character of the work to be done. This, in a sense, forced the Board at the outset into a partial participation in the organization of the banks themselves. There could be no complete organization until the board of directors was complete and a chairman chosen, but before this step was taken there evidently had to be a general notion of the type of organization to be worked out.

Choice of “Governors”

In this doubt and uncertainty, the first step evidently called for was that of deciding whether or not each bank was to have an operating member independent of the federal reserve agent. As to this, it was comparatively easy to reach a conclusion. The intent of the framers of the act had been that there should be such a head, the manifest desire of the member banks was that such a head should be chosen and that they should select him, the practice in bank organization recognized

the positions of chairman of the board and of president as quite distinct from each other. It was not long, therefore, before the Board reached an understanding among its members that, in addition to the chairman, or federal reserve agent, there should be chosen an operating head in each of the banks who should be the choice of the local bankers acting through their boards of directors. It was much more difficult to determine what should be the status of these heads, but after much discussion the Board finally resolved to say to all inquirers that the distinction between the federal reserve agent and the operating head of the bank was to be in a general way the distinction between the maker of a policy or the developer of a general system of organization and the factor employed to carry it out. Thus, although the selections to be made as federal reserve agents might be men who were not necessarily recognized as conspicuous bankers in the community, it was desired that the active factors in the institution should be. What to call these heads of the banks on the operating side was a question which early engaged the Board's attention and eventually resulted (although this determination was later to be bitterly regretted) in a decision to assign to each of them the title of "governor." Such choice of title was defended on the ground that it paralleled the designation in the Federal Reserve Board's own organization, inasmuch as there the Secretary of the Treasury, who was Chairman of the Board, was supported by an active operating head of the undertaking, known as Governor. By analogy, the federal reserve agent, then, as chairman of the local board of directors, was to assume somewhat the same relationship to the reserve bank as did the Secretary of the Treasury toward the Federal Reserve Board, while the governor of a federal reserve bank was to have somewhat the same functions as those exercised by the Governor of the Board. As matters later developed, this analogy turned out to be a wholly artificial or fictitious one. There was never any such resemblance between

the organization of the Board and that of the banks as was thus imagined, nor perhaps could there have been

Question of Salaries

Closely connected with the difficulties which had arisen in determining the general organization of the banks, was the matter of salaries. From the first, the Federal Reserve Board was extraordinarily timid with reference to the salary question. It recognized that to confine the salaries of the federal reserve agents to a scale comparable with those paid to government officers, would probably make it out of the question to get the abler men in the banking field to consider the places. There was, and is now, no very well-defined standard of public service in banking in the United States, and since the future of the federal reserve banks and the development of their prestige was still to be determined, it was likely to be the case that considerations of reputation would not attract men, regardless of salary, to the appointments. The Board eventually hit upon a middle ground, determining to pay a scale of salaries decidedly higher than those obtaining in the government service, but certainly much lower than those paid in the various localities to the recognized heads of banking institutions. At the same time, it found itself practically obliged to yield to the local bankers who desired to see at the head of the operating staff of their institution men of more or less proven standing in the banking community, and who were disposed to pay them on the same scale as was already applicable to the presidents of banks in the several places. The outcome of this discussion was to bring about a gradual recognition of a very much higher standard of salaries for the governors of federal reserve banks than that which obtained for the federal reserve agents or chairmen. This was an initial blunder of the first order, and was so recognized by various observers at the time, yet it was defended on the score of economy and necessity. The outcome of it was, in several

of the banks, to give to the governor a salary anywhere from 25 to 100 per cent greater than that paid to the federal reserve agent, and this discrepancy was gradually exaggerated and broadened as time went on

Said the Board in its First Annual Report (page 189)

In considering the salaries paid to officers and directors of Federal Reserve Banks, it is important that note should be taken of various considerations which have an important bearing upon the salaries established, and which account for variations in the amount paid different officials of like position. Under the provisions of section 4 the Federal reserve agents are to receive a compensation to be fixed by the Federal Reserve Board and their salaries were therefore established by the Federal Reserve Board in first instance the aim being to avoid payment of salaries which could be considered excessive but at the same time to pay such salaries as would be sufficiently similar to salaries paid to bank officers in the various districts to enable the board to secure for this important position men of the very highest type as to ability, experience, and character. The following salaries were accordingly fixed

District No 1	Boston	Frederick H. Curtis	\$10,000
District No 2	New York	Pierre Jay	16,000
District No 3	Philadelphia	Richard L. Austin	10,000
District No 4	Cleveland	D. C. Wills	10,000
District No 5	Richmond	William Ingle	10,000
District No 6	Atlanta	M. B. Wellborn	6,000
District No 7	Chicago	C. H. Bosworth	10,000
District No 8	St. Louis	William McC. Martin	10,000
District No 9	Minneapolis	John H. Rich	7,500
District No 10	Kansas City	J. Z. Miller, Jr.	7,500
District No 11	Dallas	F. O. Tenison	6,000
District No 12	San Francisco	John Perrin	12,000

The salaries and fees to be paid to deputy Federal reserve agents, directors, and to other officers of the Federal reserve banks, including governors, etc., were unlike those of the Federal reserve agents, to be fixed by the boards of directors of the several Federal reserve banks, subject to the approval of the Federal Reserve Board, as provided in the following paragraph of section 4

"Directors of Federal reserve banks shall receive, in addition to any compensation otherwise provided, a reasonable allowance for necessary expenses in attending meetings of their respective boards, which amount shall be paid by the respective Federal reserve banks. Any compensation that may be provided by boards of directors of

Federal reserve banks for directors, officers, or employees shall be subject to the approval of the Federal Reserve Board "

In accordance with this provision, the several banks have established salaries for the chief executive officer, or governor, and the salaries thus fixed, which have been approved by the Federal Reserve Board, are given below. In addition to this, the board has in a few cases approved the salaries fixed by the banks for officers other than the governor, but as the banks in several districts have not yet completed their organization, it is not deemed advisable to give at this time a list, which would necessarily be incomplete, of the salaries paid to the subordinate officials of all the banks.

District No 1	Federal Reserve Bank of Boston, Alfred L Aiken, governor	\$15,000
District No 2	Federal Reserve Bank of New York, Benjamin Strong, Jr, governor	30,000
District No 3	Federal Reserve Bank of Philadelphia, Charles J Rhoads, governor	20,000
District No 4	Federal Reserve Bank of Cleveland, E R Fancher, governor	16,000
District No 5	Federal Reserve Bank of Richmond, George J Seay, governor	10,000
District No 6	Federal Reserve Bank of Atlanta, Joseph A Mc- Cord, governor	9,000
District No 7	Federal Reserve Bank of Chicago, James B Mc- Dougal, governor	20,000
District No 8	Federal Reserve Bank of St Louis, Rolla Wells, governor	20,000
District No 9	Federal Reserve Bank of Minneapolis, Theodore Wold, governor	15,000
District No 10	Federal Reserve Bank of Kansas City, Charles M Sawyer, governor	7,500
District No 11	Federal Reserve Bank of Dallas, Oscar Wells, governor	12,000
District No 12	Federal Reserve Bank of San Francisco, Archi- bald Kains, governor	15,000

The board has decided to approve for the directors of the Federal reserve banks a fee of \$20 for attending a directors' meeting and of \$10 for attending meetings of the executive committee. In addition to this, directors living more than 50 miles from the reserve banks will be allowed a per diem fee of \$10 for every day's absence from home necessarily involved in such attendance, plus actual necessary traveling expenses.

Jealousy of Officials

The discrepancy in salaries was keenly felt by the federal reserve agents at the outset, and was regarded by them as

assigning them to a decidedly lower place than that occupied by the governors of the banks. At the outset, certainly, there was not the slightest warrant for any such point of view, but in a commercial community where the relative importance of men is largely determined by their income, an inference of this sort will hardly be avoided. The banking community almost at once regarded the Federal Reserve Board as having admitted the subordination of the chairman or federal reserve agent to the governor, and the latter officer almost at once began to assume powers of control and direction which in some instances were carried to an extreme that practically made the federal reserve agent a subordinate. The federal reserve agents had been chosen for the most part from among secondary figures in the banking world, men of good standing and respectability, who, however, were not regarded as of the first initiative or capacity in their several communities. Politics was rather studiously excluded from the choices, and the twelve chairmen, or federal reserve agents, first chosen were unquestionably in the main men of good capacity as well as good standing. They were deficient in independence and in most cases entirely deficient in knowledge of what the system was or was not intended to be. Few, perhaps none, of them were inclined to vindicate their own position against that of the governor of the bank, or to attempt to sustain the views of the Federal Reserve Board, or to assert a definite authority on their own part. Quite a number of them were frankly doubtful about the capacity of the Federal Reserve Board and about the working of the system, and were disinclined to await developments or to assist in framing and developing the administrative structure of the new system. Some of them found themselves, as one expressed it, "like cats in a strange garet," and were about as eager as such cats to find new homes for themselves. In some cases they soon did so. Governors of the federal reserve banks in most cases settled down to regular administration of the affairs of the institution, regarding themselves as the

direct representatives of the local bankers and showing much less restlessness, although even among them changes of personnel were not very long deferred

Awkwardness of Bank Organization

There was an undoubted awkwardness in the original organization of the federal reserve banks themselves. Nothing of exactly the same kind had previously existed in the United States, and it was therefore difficult to find precedents for the many things that were to be done. The relationship between the federal reserve agent, or chairman, and the governor was in each bank a source of difference of opinion and in some cases of friction. The duties of the deputy federal reserve agent (the second of the government directors appointed by the Board) were not clear, nor was it obvious at the outset whether the act had intended to have the deputy a substantially paid member of the staff or merely one who should come in to take the place of the federal reserve agent in the event of some long-continued disability of the latter. The relationship of the federal reserve agent and his staff to the staff of the bank, and the exact division of his duties between the two ends of the organization was a continuous source of difficulty and one which even as yet has not been overcome. The functions of the executive committee and of other committees needed to be worked out, and it promptly appeared that the standard draft of by-laws which had been tentatively adopted at the organization convention at Washington was not sufficiently detailed to cover all of the situations that were likely to arise from time to time. All this constituted a problem of organization which was of no mean difficulty and would have been of pressing significance had the banks had very much to do. The fact that they were comparatively idle and had but few customers for many months after their organization gave an abundant opportunity for gradual formation of the internal organization, but, on the

other hand, this very lack of intense demand for the performance of work probably tended to increase the elements of friction and difference of opinion which always manifest themselves in any large organization. Certain it is that the Federal Reserve Act, had it undertaken to specify the internal organization of the federal reserve banks, could hardly have been less efficient than were the reserve banks and the Board themselves in developing such an organization, and the experience which was thus gained tended strongly to throw into a favorable light those portions of the act which had distinctly mapped out and specified banking relationships in the first place.

Governors and Directors

Possibly the most serious difficulty in this whole process of internal reserve bank organization was found in the relationship of the governors of the banks to the boards of directors. The Federal Reserve Act had made no mention of the governor as such, and his status was therefore entirely indeterminate. In some of the reserve banks it turned out that the directors chose one of their own board to act as governor, and in these cases a difficulty was eliminated because of the fact that the choice of governor had fallen upon one who was already included within the directorate. In other cases, however, and these the large majority, the choice of governor fell upon a man who had neither been designated by the government nor chosen by the banks as a member of the board. It seemed out of harmony with custom and perhaps out of harmony with the canons of efficiency, that there should not be a close working relationship between the operating officer of the bank and the board of directors. Accordingly, in every reserve bank it came to be the custom, soon after the beginning, to have the governor sit with the board although not able to vote, and out of this somewhat anomalous state of things came the more or less official request to the Board that whenever, a

governor was to be chosen the Board name him as one of the three government directors—a proposal which totally ignored the entire purpose of the act in providing for the three government directors, since it would *ipso facto* have given the local board of directors the power of adding another to those already chosen by the member banks

Governors and the Larger Banks

This evidently could not be considered, and as an alternative came the suggestion in some districts that a governor when so chosen should become a candidate for the election on the part of probably the larger of the three groups of banks into which the members had been divided for voting purposes. This, for obvious reasons, turned out to be an impracticability, more particularly in view of the fact that the directors already chosen showed no inclination to commit official suicide in order to leave a vacancy which might be filled by a new governor. Although it was suggested to the Board on various occasions that it request from Congress such a modification of the act as would permit ex-officio membership on the part of the governor of each federal reserve bank in his own board of directors, no such recommendation was ever made. In lieu thereof it came to be the practice (in substantially all of the reserve banks) to have the governor officially designated, either in the by-laws or as the result of custom, a member and frequently the chairman of the executive committee of the board, the anomaly thus being presented of the chairman or member of a body in which he had neither a regularly recognized voice or vote. Inasmuch as in most cases the federal reserve agent, as the chairman of the board of directors itself, was not designated as a member of the executive committee, and certainly not as the chairman, there was presented in sundry of the reserve banks the curious reversal of position whereby one who was at first an outsider became the head of the operating mechanism of the institution, for while the

federal reserve agent was designated by the government as the titular chief, he became practically only a figure-head vested chiefly with the duty of presiding at the meetings. This state of things unavoidably gave to the federal reserve agent a peculiar and not very satisfactory position.

Subordination of Reserve Agents

In most cases, it was true, the reserve agent contrived to maintain his titular headship with dignity while at the same time yielding to the governor on all questions of practical operation, but in others it shortly became plain that the reserve agent must choose between practical isolation on the one hand and complete subordination to the governor of the bank on the other. The latter attitude was the one which in most cases was more or less consciously adopted. Reserve agents reconciled themselves to a position as practically nothing more than an ordinary officer of the bank, and in some certainly sank into a position of inferiority both as to salary and as to influence, not merely to the governor but also to one or more vice-governors. They accepted assignments of duty from the governor and vice-governors, reported to them and practically observed their orders, continuing to act as the technical representative of the Federal Reserve Board, making the regular formal reports required by law or by regulation and carrying out also such orders as might be transmitted by the Board, but apparently in no way regarding themselves as exercising a very special function in safeguarding the peculiar interests of the government or of the public. It would probably be hard to find any occasions on which a reserve agent ran directly counter to his associates in the organization, save perhaps in some very unusual conditions which compelled such action. The results of this reversal of authority were of course profound, but they were nowhere greater than in the fact that inferences came to be plainly drawn from this subordination of the federal reserve agent that the Board itself was to be

regarded as more or less subordinate to the banks. The initial stages of this idea had already been observed in the formation of the governors' council, which is shortly to be described.¹ The basis of this enterprise undoubtedly was to be seen in the thought that it would be well to have the banks form a union or organization among themselves which might take the place of the central bank or central office, the Board thus being left practically to fill the position of an expanded and improved Comptroller's office, although the Comptroller himself was still in existence and was still determined to maintain all of his old powers as against the Federal Reserve Board.

It was an unfortunate thing that the Reserve Board should have allowed so complete a transformation of the intent of the law in the management of the reserve banks to take place, but it would probably be impossible to find any occasion upon which the Board, either directly or indirectly, declined to assent to it, although individual members from time to time expressed themselves positively with reference to the situation thereby created. It was, at all events, a condition and not a theory which had thus been brought into existence, and with every passing month the condition strengthened itself and became more and more nearly ineradicable. The situation produced by it attained perhaps its most absurd form in some cases where, after a year or two, federal reserve agents changed places with governors²—the latter becoming federal reserve agents, the former taking over the governorship, always on the ground that the reserve agent who thus drove out the governor had first succeeded in obtaining control of the bank and had shown himself the "stronger" man of the two, the obvious conclusion being that there was something in the position of federal reserve agent which essentially called for weakness or subordination and which therefore required the presence of those traits in the occupant of the place.

¹ Chapter XXXII

² E.g., in Kansas City and Atlanta.

Auditing and Oversight

The issues between governors and reserve agents were quite sharply drawn in connection with what might at first appear to be a comparatively minor matter of administration, namely, that of auditing. It had been the opinion of those who were most concerned in the organization of reserve banks that the auditing of the bank should be under the direction of the federal reserve agent as representative of the entire board of directors, but in some banks it shortly appeared that the governor desired to have charge of the auditing department. Eventually it was settled in most of the reserve institutions that the auditing should be directly under the control of the reserve agent, thus observing the principle that the actual operating officers of the bank should not control the auditing, and gradually this view of the case made itself felt, at least in theory, practically throughout the system. A similar question arose in connection with the examination of reserve banks and the reporting of the findings of examiners. These were naturally to go to the reserve agent both as chairman of the board of directors and as the immediate representative of the Federal Reserve Board itself. To this, again, exception was taken by sundry of the governors of the banks. A compromise was finally reached through the development of the practice of handing a copy of the examiner's report both to the reserve agent and to the governor.

Joint Communications

So sharp did the conflict at times become that during the Board's first year of administration, merely in order to avoid constant friction and annoyance, it developed the practice of sending letters in duplicate so that whenever any general letter of instructions was addressed to the federal reserve agent by virtue of his office, a copy of it went to the governor of the bank, who was thus advised of the communication which had been received by the Board's official representative from Wash-

ington As time went on, it became more and more the practice to communicate direct with the governors of the reserve banks whenever any seriously important question was up, particularly if it required immediate attention, for it often appeared that the governors refused to follow the suggestions or requests of the reserve agents made on behalf of the Board, in the absence of the receipt of direct instructions from the Board As this practice of communicating direct with the governors was extended and strengthened, the practice of communicating less and less with the reserve agents became correspondingly well rooted, and although for a time it was the practice to send reserve agents copies of letters addressed to governors, since this appeared to be the logical outcome of the practice of advising the governors on everything written to a reserve agent, this quality of treatment gradually disappeared and the reserve agent was often uninformed of the instructions which had been sent by the Board to a governor even though they frequently related to matters in which he was at least technically deeply concerned

Board's Lack of Support

Undoubtedly this was a great error on the part of the Federal Reserve Board, since it thus committed itself to the view, at least tacitly, that the governors were more truly representative or more "real" in their authority than the chairmen of the boards of directors, the Board's own appointees It was natural, under these conditions, that the authority of the reserve agent should become largely reduced In some banks his function in large measure atrophied, while in others it was plain that to avoid such atrophy he allied himself with the governor of the bank and in effect became a subordinate of the latter In a few, continued conflicts between reserve agents and governors from time to time developed, sometimes reaching the stage in which no direct communication could pass between the two men, and on one or more occasions necessi-

tating the intervention of the Board or members thereof in order to settle the dispute, which was of no particular importance. This kind of internal "office politics" or family feud represents a situation too frequently seen in business. Wherever it exists, it is a mark of bad administration, and the fact that it developed and flourished as it did in the federal reserve system, unquestionably showed either weakness at the head or defects in the mechanism provided by the act. Members of the Federal Reserve Board were always inclined to ascribe it to the latter, and possibly with some reason. The fact remains that it was present.

General Conclusions

Notwithstanding all these difficulties and failures of administration, the gradual development of reserve banks showed that the machinery which had been provided for their management was workable and in the main efficient, certainly much more efficient than that of other government agencies and institutions. It amply proved its efficiency when the banks came to be subjected to the severe strain of the war credit demands and found themselves obliged to get real results without stopping to argue matters of official precedence or seniority. The question whether the dual headship of the banks was not an unnecessarily expensive element in their management was much debated during the early years, but was gradually forgotten as the earnings of banks increased. Experience showed that there was nothing in the laws or regulations of the Board which compelled the reserve banks to be over-officed or over-staffed, it was entirely possible to conduct them economically and efficiently. When the time came, as will later be seen, that Congress began to find fault with the organization and cost of the banks, it was necessary that these carping critics center their attentions upon the salaries of individual officers, finding as they did that the average cost of administration or oversight was not higher than that which

existed in other banks and so probably much lower than in many of them.

While it was probably never true that the organization of the federal reserve banks was on the whole as efficient, as smooth working, or as inexpensive as that of the best organized European central banks, it would have been too exacting a standard to require that a new system whose work was in large measure experimental should immediately show as good results as had been attained by institutions some of which were of a century or more in growth. On the whole, therefore, the organization of reserve banks, although attended by difficulties to which reference has already been made, may be regarded as having justified itself by experience and as having afforded at least a measurably efficient system of operation. In fact, as will be readily inferred from this chapter, the most serious fault in it was found in Washington, and was due to lack of continuity of purpose and courage in dealing with difficult or disputed points.

CHAPTER XXXII

THE GOVERNORS' COUNCIL¹

Origin

Probably during or immediately after the organization convention held at Washington in the autumn of 1914, there was effected an organization which later became known as the "Conference of Governors." The precise origin of this conference of governors is obscure and there is, so far as can be learned, no written available evidence to show with whom the idea of it originated. It has sometimes been ascribed to one of the members of the Board, but is by others regarded as having been conceived of by some of the larger banks which viewed with apprehension the development of a banking body, supposedly of great power, at Washington, and desired in some way to offset it. Whatever the origin of the conference of governors may have been, it is certain that before the close of the Washington convention, which was the subject of a former chapter, the outlines of the conference of governors had been perfected and plans laid for an early meeting at which should be discussed some of the general questions which must be settled before the new banks could be effectively opened for business.

Some Tendencies

The undertaking was so symptomatic of sundry tendencies which prevailed during the early years of the system as to

¹ There is practically no published information regarding this body. It has issued no reports so far as known, and the Board has never described it in the regular annual reports. Stenographic minutes of its meetings have been kept and filed, in whole or in large part, with the Board.

merit some detailed study. In effect, it was a new phase of the ever-recurrent effort to create a central organization or interbank board of control not known, and hence not subject to law or administrative control.

During the first few months of its existence, this so-called council held numerous meetings nominally for the discussion of system business. While some of these meetings occurred in Washington, and while at certain of the sessions a member or members of the Federal Reserve Board were invited to participate or attend (a joint session at which the whole Board was invited to be present usually closing the series of meetings), the attitude of the council and its representatives grew more and more peremptory and domineering. The council had organized by electing a chairman and a paid secretary, both of whom were officers of the Federal Reserve Bank of New York, and there was a growing disposition among the membership to think and act as if this council were the real arbiter and final authority in all system matters—the Board becoming only a ratifying body.

Responsibility of Board

For this point of view and for the tendencies evidenced in the governors' council, the Federal Reserve Board had only itself to thank. There was, as already noted, a prevailing belief that the organization had been formed with the encouragement of a member or members of the Board. Be this as it may, it remains true that there existed from the outset a sharp division of opinion in the Board itself respecting the place to be taken by the council and the attitude to be assumed with regard to it. While, however, this difference of opinion was sharply defined as between certain of the members, the majority were passive and inert, indisposed to act with regard to the organization and inclined to await developments. Governor Hamlin, although perceiving the dangers and possible outcome of the council, was not prepared at that time to raise

any sharp issue with its members, and thus the organization continued

Change of Name

Practically the only change in the governors' association, made unquestionably as a concession to the manifest feeling of the Board, was a change of title. The word "Council," which had at least informally been employed from the beginning as a descriptive term, was abandoned, and the sessions from about 1916 onward were referred to as the "Governors' Conference" or "Conference of Governors." By whatever name designated, however, the functions of the organization were gradually broadened. It came to assume the duty of recommending changes not only in policy but also in legislation and, according to report, from time to time sent representatives to the Capitol for the purpose of advocating or opposing legislation. Even this would probably not have brought action of a direct sort from the Board, had it not been for a final development. Members of the conference began to respond to orders or rulings issued by the Board or its Governor, with the statement that they would prefer to postpone action until after the next session of the conference, or occasionally to say that a given order or direction was out of harmony or in conflict with a given order or resolution of the conference.

Governor Hamlin had terminated a two-year term of office on August 10, 1916, and had been succeeded by Governor Harding. The latter from the beginning of his term as a member of the Board, had been decidedly of the opinion that the governors' organization contained seeds of serious danger. He now proceeded to act upon the conviction formed during his period of membership while he still held no executive office.

Attempt to Restrain Governors

While no very definite attempt to restrain the doings of

the board of governors had been made during the first two years of the board's life, the subject had often come up for consideration. Governor Harding, although friendly to all legitimate activities of reserve banks, had always been of the opinion that there was serious ground for doubt as to the propriety of this undertaking. He early announced it as his policy to check the too frequent meetings of the governors and, if possible, to have them held in future in Washington only. During his first year, however, there was scant opportunity to attempt any definite check to the activities of this unofficial body. These, as just noted, had become more and more pronounced, and in a certain sense antagonistic to the policies of the Federal Reserve Board. Although defiance of orders was invariably conveyed in veiled language, there could be no doubt as to its meaning. The Board was eventually obliged to adhere to the belief that there was a union or trust among the heads of the several banks whose primary purpose it was to bring about uniform action, some elements of which at least were intended to be in direct opposition or contravention of the wishes or views of the Board, notwithstanding that the latter was acting in entire accordance with law in the instructions that it might issue. So soon as this view had been definitely, even if reluctantly, assented to, Governor Harding communicated with the various heads of banks, expressing to them his dissent from the position assumed, and advising them definitely that in future the Board could not authorize further independent meetings of governors or consent to approve the expense accounts involved in the attendance of members of the reserve banks thereat. This communication was conveyed partly by official letter and partly by conversation, but the policy adopted was made unmistakable.

Protest Against Board's Policy

The announcement of a new policy thus conveyed to the governors naturally aroused protest on their part, and resulted

in one or two resignations, which, though not officially based upon the new attitude of the Washington authorities, were quite definitely understood to be, at least in part, the product of the action thus taken. Those who neither resigned nor threatened resignation expressed strong protest against the new policy, although professing the intention to observe it, at least in the letter. As a matter of fact, informal meetings of the heads of banks could not be prevented, nor when they occurred could the discussion of system matters be tabued. In fact, there had never been any reason why this kind of informal discussion should be objected to. It was only the creation of a definite organization, some at least of whose activities were devoted to retarding the Board's policies or developing new ones, that afforded legitimate ground for objection. With this discontinued, both the basis for outside criticism and the real existence of a nucleus of antagonism and insubordination within the system was removed. This desirable consummation in so far as attained, was not, however, reached until long after the organization period had ended. In the meantime the organization process was seriously obstructed by the existence of the unofficial and unauthorized body which has just been described, and whose activities took form along lines which will be incidentally sketched in later chapters.

Effort to Re-establish Governors' Conference

Notwithstanding the positive position taken by the Federal Reserve Board with reference to the governors' conference, the idea of an independent body practically ruling the system and giving to the reserve banks the complete "right of self-government," was never surrendered. It recurred early in the spring of 1922 and is before the Federal Reserve Board today, with tentative action apparently against the re-establishment of the conference, but with the whole situation evidently depending

upon the policy to be developed under the reorganized management of the Board resulting from the new appointments made by the Harding administration. The 1922 demands were confined chiefly to concession by the Board of the right on the part of the governors to meet officially when and where they would for the purpose of independent deliberation, free of supervision (and presumably of the presence of any members) of the Federal Reserve Board itself. Governor Harding, who was then at the head of the organization, declined to change his past position, and has always taken the attitude that the formation of a rival body of central control was not likely to conduce to the efficient management of the reserve system at the hands of the Federal Reserve Board itself. This position has been independent of the question whether the council of governors would or would not work in harmony with the Board, it was simply based upon the belief that two central bodies, each with its own policy and each giving orders, no matter how friendly or "close" to one another they might be, were not likely to produce good results. As to this, no one who has observed the working of the conference of governors can doubt, and the other members of the Board have in recent years given general support to the position assumed by Governor Harding, notwithstanding that at times individual members have doubtless sympathized with the objects apparently sought by the governors' council.

In order to retain such benefit as there might be in the work of the conference, the Board, however, announced that it would from time to time summon meetings of governors, to be held with one or more Board members present, in the Board's own offices in Washington. The meetings have since then been more or less regularly held, and have apparently produced all the good results that had been hoped from the earlier council organization while many of the evil incidental consequences were eliminated.

Reserve Agents' Conference

Not long after the formation of the original council of governors, the Board had sought to apply the principle of counter-irritation, by summoning the federal reserve agents in session. At this session, attention was given to problems especially affecting the department of the federal reserve agent, and in succeeding sessions these discussions were continued and sustained. Unlike the governors' council, the federal reserve agents' association met only on call of, or after arrangement with, the Board, and usually confined itself to a program which had been agreed upon with the Board in advance. It had no formal organization, but named a chairman who appointed committees and managed the general organization and operation of the meetings. The meetings have continued at regular intervals up to date, and have alternated with those of the governors, except upon occasions when it has been thought worth while to summon a joint session. Both at the meetings of the reserve agents and at those of the governors, stenographic copies of the discussions have been made and have been filed with the Board.

A Standing Element of Organization

The meetings of these unofficial bodies have now become a stereotyped feature of reserve system organization, and the fact naturally raises the question whether there has been a need for connecting links of a sort not provided for in the Reserve Act which would unite the Board far more closely with the several banks. This question is of far more significance than the mere detail of controversy between different elements in the system. Was there ground, in fact, for the belief that the Board was not provided with due powers or was too far removed from the details of practical operation to do good work, or was it true that the theory of the Reserve Act making a sharp separation between banking theory and banking operation was a mistake?

The question raises many issues of urgent administrative interest and significance. Just as the striking and outstanding organization feature of the Reserve Act was the separate establishment of the banks and the creation of the Board to supervise them, so the efficiency or inefficiency of the mechanism thus provided is in no small degree a test of the satisfactory working of an important experiment in financial control. Experience with the unofficial organizations is, therefore, of value as a datum in connection with future organization. Of the two bodies, however, the governors' organization is far the more striking.

Some Problems of Governors

Needless to recall, the conference of governors was a body not only unknown to the Federal Reserve Act and never contemplated by its framers, but manifestly out of harmony with the ideas laid down in the act and in all of the discussions that it created during the time the bill was under consideration, as well as subsequently. The formation of such a body, created as it was without the sanction of the Board, the Treasury Department, or, so far as known, of the reserve banks themselves, could not be regarded other than as an act of the purest usurpation and assumption of authority.

Significance of Issue

The question of the governors' council is not a mere question of "office politics" or intrasystem scheming. It is not merely an instinctive movement designed to supplement the efforts of an insufficiently strong or politically influenced board with the decisions of a group of men presumably affected only by business considerations. The real essence of the problem presented by the governors' council has always been whether it was possible to insure real public participation in the management of the federal reserve system. Representing, as they naturally have, the purely banking interests of the districts, the

governors at reserve banks have invariably tended to minimize the public functions of their institutions. It has always been evident that some body upon which the nation at large was specifically represented must exercise a share in the management of the enterprise in order to insure public confidence, if for no other reason.

The initial effort to organize the council of governors was undoubtedly the outgrowth of a general desire to bring about the creation of a central bank or the equivalent thereof, operated by bankers or their representatives and bringing about a uniformity of policy throughout the whole country which should ensure bankers in one part of the country from having to reckon with the effects of a somewhat different policy in another. If this was in fact the purpose of it, it is easy to see that there was reason for the persistent attempts, still in progress, to bring about the formation of a central body more or less independent of the Federal Reserve Board, by isolating the latter and giving it a status merely as a kind of inspection organization or body of general oversight, somewhat resembling in its main functions the Comptroller of the Currency. That such a result may follow from the continued existence of the council or board of governors, especially if permitted an independent existence, is the obvious conclusion to be reached from the premises in the case. It contains the unusual element of danger that the findings of such a board, if actually made effective, as in years past they have been, emanate from a body in no respect known to the law, bound by no regulations even of an administrative character, not restrained in its expense save in so far as the several reserve banks might choose to restrain it, and unregulated in its composition. Although thus far held back and at one time, as already seen, nipped in the bud, the development of this extra-legal organization must undoubtedly be regarded by the unprejudiced observer as one of the most portentous developments in the federal reserve system, and although it has received no attention in Congress

or elsewhere from the critics of the system, it perhaps deserves, more than any other one thing, to arouse doubt and objection. This is said quite without any reference to the decisions reached by the board of governors, and is based simply upon the fact that the very existence of such a body in its older form might well arouse suspicion and objection.

Imperfections of Machinery

This still leaves open the question, already briefly referred to, whether the formation of the governors' council with the subsequent establishment of the federal reserve agents' conference, as well as the continuation of the governors' organization in the conference form at the request of the Federal Reserve Board, implied a serious imperfection in the original machinery of the reserve system. Was the system lacking in centralization or communication between banks? Did it call for administrative bodies supplementary to the Federal Reserve Board and the Federal Advisory Council? This is a question of great interest in judging of the operation of a banking system constructed upon the so-called district plan. Referring back to the early history of the Federal Reserve Act, as already outlined in Chapters XII and XIII, it will be remembered that the first drafts of the measure had sought to create a more or less democratic body at Washington which should in some measure be representative of the reserve banks and to that extent be controlled or influenced by them. Would this have been a more effective means of organization?

The experience of the federal reserve system certainly appears to indicate that the central co-ordinating mechanism which had been provided in the law was not sufficient, and that in the absence of other and supplementary methods of securing harmony and unity of action, the several districts might have developed on non-parallel lines. To put this in another way, it seems fair to assume that the frequent conference of reserve agents and of governors, whatever faults

they may have had, also performed a certain needed service, else perhaps they would long ago have been discontinued. That service consisted primarily in the interchange of views, and the understanding of personnel and organization problems which existed in different districts in different forms and which might have been solved in ways that would eventually have brought about a rather inharmonious type of development. The answer to this suggestion is, of course, found in the statement that the Federal Reserve Board, had it developed a sufficiently elaborate and effective organization, might have put itself into position to keep closely advised of developments in the several districts and might more easily have kept its hand actually upon the machinery of the several reserve banks. Lacking this, and lacking an inclination on the part of several members of the Board to travel widely and frequently, the plan of having as many of the heads of the banks as possible come to Washington at occasional intervals afforded a more or less acceptable substitute. As an alternative to extensive travel on the part of the members of the Board themselves, it would, of course, have been feasible to develop a subordinate corps of inspectors, including men of competence and enjoying the entire confidence of members of the Board itself. This plan would doubtless have failed to provide the more intimate contacts between members of the system which were gained through the method of personal conference at Washington actually resorted to. No doubt, in the eastern districts a more or less direct co-operation and comparison of notes would have developed among the banks in any case, but the situation would have been rather different in the outlying districts.

While, therefore, it may be said that the issue is certainly an unsettled phase of administrative theory, it is perhaps fair to conclude that the Reserve Act was relatively weak in its provision for unification of policy and for harmonious administration, and that it was naturally and properly supplemented by the methods that were followed by the Board, and by others

resembling them, with the object of developing a smoothly working and well co-ordinated mechanism. In future years it may easily turn out that this mechanism will call for considerable modification and that changes of an important type will have to be made in it. As the system grows older and its methods and precedents are better established, there should be less uncertainty and less need for consultation and adjustment. Probably, on the whole, the administrative machinery provided by the Reserve Act went about as far as it was wise to go in legislation, while the work done by the Federal Reserve Board in supplementing and strengthening it may be regarded as having in the main carried out the purposes of the act and rendered its working more efficient. An independent and unregulated governors' council as a counterpoise to the Board is not to be thought of. It is unlikely that the public will ever tolerate it.

CHAPTER XXXIII

THE FEDERAL ADVISORY COUNCIL

Provisions of Laws

At an earlier point it has been seen why and how the body known as the Federal Advisory Council had been provided for¹ This organization, it will be recalled, was what had been saved from the plan of the original bill which had sought to create a self-governing banking system That original plan had contemplated a central body composed of bankers and chosen in large part by the banks themselves The plan had been sacrificed to Mr Bryan's scruples, and the central co-ordinating mechanism of the system (the Federal Reserve Board) had become a board of presidential appointees Yet, in the endeavor to provide some direct means of shaping the course of the system along democratic lines, the act had provided for a council of bankers to represent the several districts and to be chosen each in his own district by the local federal reserve bank The provision was as follows

There is hereby created a Federal advisory council which shall consist of as many members as there are Federal reserve districts Each Federal reserve bank by its board of directors shall annually select from its own Federal reserve district one member of said council, who shall receive such compensation and allowances as may be fixed by his board of directors, subject to the approval of the Federal Reserve Board The meetings of said advisory council shall be held at Washington, District of Columbia, at least four times each year, and oftener if called by the Federal Reserve Board The council may, in addition to the meetings above provided for, hold such other meetings in Washington, District of Columbia, or elsewhere, as it

¹ Book I, Chapter XV, p 325

may deem necessary, may select its own officers and adopt its own methods of procedure, and a majority of its members shall constitute a quorum for the transaction of business. Vacancies in the council shall be filled by the respective reserve banks, and members selected to fill vacancies shall serve for the unexpired term.

As the selection of members of the council could not be made until after the organization of the board of directors of each federal reserve bank, complete membership of this body was not determined until December 8, 1914, at which date notification was received by the Federal Reserve Board that the last of the elections of members of the advisory council had been held. The Federal Reserve Board thereupon sent to each newly elected member of the advisory council an invitation to meet at Washington on December 15, 1914, recognizing that the federal advisory council is a separate and independent body, but feeling that courtesy demanded that an invitation should be extended to meet with the Federal Reserve Board at the earliest possible date. The meeting was accordingly held December 15 and 16, 1914, and the federal advisory council organized by electing the following officers: James B. Forgan, president, Levi L. Rue, vice-president. Executive committee: Messrs. James B. Forgan, Levi L. Rue, J. P. Morgan, Daniel G. Wing, and W. S. Rowe.

Under the provision of the Federal Reserve Act cited above the term of office for a member of the federal advisory council is one year, during which period at least four meetings are to be held. The first members of the council were as follows:

Daniel C. Wing, representing district No. 1, president
First National Bank, Boston

J. P. Morgan, representing district No. 2, J. P. Morgan &
Co., New York

L. L. Rue, representing district No. 3, president Phila-
delphia National Bank, Philadelphia

W. S. Rowe, representing district No. 4, president First
National Bank, Cincinnati, director Federal Reserve Bank of
Cleveland.

George J. Seay, representing district No 5, governor Federal Reserve Bank of Richmond

Charles A. Lyster, representing district No 6, president First National Bank, Chattanooga

James B. Forgan, representing district No 7, president First National Bank, Chicago, director Federal Reserve Bank of Chicago

Rolla Wells, representing district No 8, governor Federal Reserve Bank of St. Louis

C. T. Jaffray, representing district No 9, first vice president First National Bank, Minneapolis

E. F. Swinney, representing district No 10, president First National Bank, Kansas City

J. Howard Ardrey, representing district No 11, cashier City National Bank, Dallas

Archibald Kains, representing district No 12, governor Federal Reserve Bank of San Francisco

Worth of Council

How fully could this organization be expected to function? That question was perhaps the hardest to answer that presented itself during the organization period. The establishment of the Council was effected without delay, the first meeting occurring at Washington on December 15, 1914, and the membership being on the whole very distinctly representative of the banking talent of the United States. It included at least two names of national financial distinction, while practically the entire membership consisted of bankers widely, and for the most part favorably, known in their respective portions of the country. Both in original design and by virtue of membership, the Council should have occupied an important and influential position in the evolution of the system.

Early sessions of the Council, however, soon raised serious doubts in the minds of careful observers. It began to be evident, from a date very soon after organization, that the Council was likely to be a purely perfunctory body. Not only did its members for the most part assume a detached and indifferent attitude, but it was painfully plain almost from the

very beginning that they had but little knowledge of central banking problems. This situation was reflected in the somewhat dry comment carried in the Board's first annual report

The 12 members of the Advisory Council are selected by the boards of directors of the Federal Reserve Banks. When the list was completed the Federal Reserve Board sent out an invitation to the members to meet, which they did in Washington on December 15 and 16. At this meeting the members of the Council indicated their views on some pending questions and took others under advisement to be reported upon later.

Official Records

No very detailed or complete account of the doings of the Federal Advisory Council has ever been published,² and the regular sessions held by the organization have ordinarily been regarded as semi-confidential, only a bare statement to the press, which usually conveyed no definite information, being issued. Practically the first approach to anything in the nature of a report or review of what the Council had done was furnished in the year 1917, when it was determined to issue a brief pamphlet containing the questions which had been considered by the Council from the beginning of 1915 up to that time and the answers which had been returned to them. A reading of this pamphlet thus affords some insight into the character of the topics considered by the Council during the first few years of its existence and also of the point of view which was adopted with regard to them. It also furnishes a general idea—nominally at least—of the method of discussion and of presentation of questions. It does not afford any insight into the character of the deliberations or the different

² The Federal Advisory Council holds stated meetings every three months, and from the beginning has maintained a careful set of minutes. Records are thus available to show the position taken by members in so far as recorded. At the regular meetings of the Council, attendance is limited to the membership but it has been customary to hold at least one, and often more sessions at each stated meeting, jointly with the Board, for the purpose of common deliberation and for the purpose of conveying to the Board in a formal way the outcome of what had been done during the private or confidential sessions of the Council. At these joint meetings subjects of general interest have been canvassed in informal discussion.

elements existing within the organization. Digests of subsequent sessions are usually printed as Part III of the Board's annual report each year.

First Recommendations

The Federal Advisory Council's work during the first years of its existence may be fairly seen in the recommendations which, as just noted, were published for the first time in 1917. This first official publication contained the records of the meetings held on February 15, May 16, September 18, and November 20, of 1916, and those of January, 1917. The period was a representative one so far as pre-war or early federal reserve organization problems were concerned, and the findings may be taken as fairly representative. On the Board's discount policy the Council took the view that rediscount rates should be maintained in excess of current open market rates, and that apart from this there was no reason to think that the Board could do anything to bring about a "contraction of credit." The Council practically neglected the Federal Reserve Board's open market power. As to the question of a revision of the grouping of cities under the head of "reserve" and "central reserve," the Council suggested that when banks in reserve cities "lose their privilege of acting as legal reserve agents," their reserve requirements should be reduced to a parity with those of cities of similar kind. As to the clearing of checks, the Council noted that the topic was one of "vast detail" and that it therefore "hesitated to offer any suggestions." As to the maintenance of the capital stock of federal reserve banks at its then existing level, the Council recommended no reduction, but there was a minority which desired to reduce it. As to agencies abroad, it was suggested that foreign banks operating in the United States should be subjected to restrictions designed to hamper their competition with local banks. With regard to bankers' acceptances, it was recommended that federal reserve banks adopt the same policy

as foreign banks in shifting their rates to meet market rates in competition. Federal reserve banks, it was argued, should conserve their cash reserves with a view to meeting possible emergencies caused by European conditions. Changes in the Federal Reserve Act were recommended for the purpose of permitting the issue of federal reserve notes directly against the deposit of 100 per cent of gold, also in favor of a change in the Federal Reserve Act transferring the entire reserves of member banks to reserve banks, also in favor of permitting non-member banks to join in the check collection system, also to permit member banks in large cities to establish branches in those cities where they were situated.

Later Suggestions

A review of this record for 1916-1917 gives a fair idea of the kind of advice furnished by the Federal Advisory Council. Later findings and responses to the Board did not vary widely in character from those that were offered during the earlier period, although as the war came on and public finance emerged into the foreground of national thought, the significance of their recommendations assume from time to time a rather broader bearing. On the whole, however, the Advisory Council continued to be merely a conservative financial body, keen to protect the interest of member banks, deeply concerned with the welfare of the business as such, and not primarily devoted to the study of central banking in its larger aspects. Detailed reference to its recommendations will be made from time to time as the history of the federal reserve system advances.

Desire to Co-operate

Broadly speaking, the Council has from the beginning been somewhat disposed to shape its deliberations along lines indicated by the Federal Reserve Board. The Board has usually framed series of questions upon which it desired to ask the

opinions of the Council, preparing them, as a rule, some weeks or even months in advance of the meeting and accumulating them pending the arrival of the Council itself. At times, however, it has been deemed best to send out these lists of questions in advance, in order that at all events the officers of the Council, and occasionally its entire membership, might have a chance to consider the points to be dealt with and possibly to obtain a view of the sentiment of the local banking community in each district. It has, of course, never been true that the Council was bound to limit itself to the fields set forth in the Board's questions, but it is probably fair to say that there has been a tendency to do so although frequent additions to the list of topics have been made by members of the Council themselves. The list of questions has served as a guide for debate which might otherwise be rambling or fragmentary, and has served the purpose of affording a basis for the making of a definite report upon outstanding topics considered to be of primary importance in the working of the federal reserve system. In so far as there were questions which related to the system and its future and which were evidently uppermost in the minds of local bankers, the representatives of the several districts have naturally felt bound to present such topics in order to get the views of both their colleagues and the Federal Reserve Board.

Changes in Membership

Relations between the members of the Advisory Council and the boards of directors of the several banks have varied a good deal from district to district and from time to time as the composition of the Council changed. In some districts the relationship at times has been little more than perfunctory, the member accepting appointment as a local recognition or honor, holding no very close communication with the bank which had chosen him, and in some cases being anything but regular in his attendance on meetings. In others the practice of regard-

ing the member of the Advisory Council' as a direct representative, sent to Washington to review the conditions of the system and bound to report back directly to the Board which named them, has prevailed, and regular reports have been furnished concerning the meetings, while regular suggestions or recommendations have gone from the bank to the member prior to his trip to Washington. These, however, could never be very specific, since the subjects to come before the Council have almost invariably been broad and vague, without points which call for decisive action or recommendation in regard to particular matters. The Council, therefore, even when its members had been quite recently and quite closely in touch with the boards of directors of the local reserve bank, has had a comparative looseness and vagueness in its deliberations which perhaps made for a broader point of view, but which tended to impair the conclusions reached because of inability or failure to cope with given situations.

Safeguarding Member Banks

As for the position taken by the Council, it must be regarded as having been throughout very conservative and on the whole designed to safeguard and protect the interests of individual member banks against possible encroachments by the reserve system. This point of view may have become somewhat mitigated in recent years but was very obvious during the early history of the new body. The members being themselves bankers, almost always eminent members of the local banking community in each district, were inevitably strongly tinged with the point of view of their profession.

These features in the organization of the Federal Advisory Council could not, of course, be foreseen at the outset, and during the first year or two of the federal reserve system remained in the background. The working of the system during those years had to do largely with questions of organization which were more or less closely prescribed by the Fed-

eral Reserve Act itself. In such circumstances the work of the Council was necessarily considerably narrowed. After the close of this purely introductory or organization period, the entry of the United States into the war once more took the development of banking policy out of the hands of bankers and made it dependent upon Treasury necessities and foreign relationships as affecting them. The suggestions and recommendations of the Council during the war were undoubtedly valuable but had more to do with the banking aspects of public finance than with technical questions of banking and credit. The Council was freely consulted by the Treasury authorities and as freely gave its advice in regard to war finance problems. It is only since the conclusion of the armistice that a really definite test of the working of the organization as a factor in the federal reserve system can be said to have been afforded, and final conclusions with regard to it can therefore be expressed only in very broad terms.

Legislative Activity

Perhaps the most striking or noteworthy activity in which the Council ever engaged was its effort to ward off the proposed action of Congress looking to the appointment of one or more new members of the Federal Reserve Board representing agricultural interests, and at about the same time its effort to impress the President and the public with the idea that an amendment of the Federal Reserve Act intended to permit the discounting of agricultural paper would be wise. These activities were undertaken toward the end of 1921, and seemed at the time to have comparatively little effect. How far they were warranted, and what inspired them, are questions which it would be out of place to discuss at this point and which must be deferred to a later point. It is only necessary to cite them here as examples of the kind of work which the Federal Advisory Council has regarded as falling within its legitimate kind of service. The action thus taken

suggests a rather important field of effort which might conceivably develop into that of shaping opinion on new legislation in the general sphere of banking and finance. Whether the Council is likely ever to develop into a body possessing the breadth of view and the public confidence in its professional disinterestedness to make such an activity offer promising possibilities, is a question which need only be suggested at this point since we are dealing now merely with the organization simply in its historical or developmental aspects. It is enough to say that, with the exception of the recommendations just cited and with the further exception of suggestions frequently put before the Secretary of the Treasury or other Treasury officers, the Council has not developed into a body of public importance, while within the system its duties have been too limited and circumscribed to permit of their exercising a very striking effect upon policies.

Criticism of Council

Perhaps the most severe criticism to be offered with respect to the Federal Advisory Council is that it has had the defects of its qualities. Being composed exclusively of active and successful bankers, it has necessarily lacked contact and sympathy with the remainder of the public—even with the remainder of the business public who are less fortunately placed with respect to their interests and investments. This lack of sympathy or breadth of view has its merits, in that it tends to keep the Federal Advisory Council within narrow bounds in its suggestions to the Reserve Board and to the Treasury while it insures extreme conservatism of utterance and statement. The trouble with the work of a body thus constituted and thus limited is found in the fact that the reserve organization, on the whole, has itself erred on the side of ultra-conservatism, tending to hold the system to a policy of overextreme care in conserving banking interests. It would have been well in such circumstances had the Federal Advisory Council been able to

exert a broadening influence, tending to give to the system a larger view of its public duties. For this the Council was never organized, and it would be unfair to blame it for not exercising a function for which it was never intended and for which it was not fitted as a result of its peculiar composition. This criticism, therefore, merely amounts to a statement that the Advisory Council has in a sense acted as a brake instead of as an accelerator, notwithstanding that the system was already oversupplied with apparatus for retarding overrapid progress. The Council has at all events performed a useful service in helping to check or anticipate the efforts of politicians to employ the resources of the federal reserve system in non-banking ways, and to that extent has discharged at least a portion of the duties which had originally been recognized as belonging to it.

CHAPTER XXXIV

CHANGING THE FEDERAL RESERVE SYSTEM

Purposes of New Organization

It was a natural outgrowth of the condition of affairs in the federal reserve system as thus sketched, and particularly of the selection of a great number of officers and employees, not only in Washington but of the several banks, who were not in sympathy with the really basic ideas of the system, that the first thought of many should have been that of altering the form of the organization. Some have supposed that there were members of the Federal Reserve Board, as well as of the directorates of the several banks, who took office with the distinct idea of immediately beginning from a point of vantage the effort to annul some of the essential features of the Federal Reserve Act. This would be a questionable motive, as to which, so far as known, no evidence can be adduced. Without attempting to suggest motive or to impute anything more than a desire to carry out the ideas to which individuals had become thoroughly committed through their own earlier work and affiliations, it is, however, fair to say that with the personnel with which the system began operations, it was reasonably to be expected that there would be an immediate effort to change many of its characteristic features.

Problem of Change

The problem where to begin this process of change must, however, have furnished many serious doubts to those who found themselves opposed to the arrangements laid down in the law. Of these arrangements the most conspicuous were

undoubtedly the transfer of reserves, the proposed institution of a collection system, and the existing type of organization, the basic element of which was the division into a sufficient number of federal reserve banks to insure, as it was supposed, local self-control of banking. The reserve transfers, however, were not to be completed under the terms of the old act for a period of three years, while a collection system might or might not be established in full force at any given time. Both these matters could obviously wait. The question of organization, however, was one which could not be thus deferred if any modification of it was to be effected before the system had grown so stereotyped and so definitely established as to make a change in its form more than difficult. As has been seen when studying the genesis of the Federal Reserve Act, the aspect of it which had received most attention throughout the discussion, notwithstanding it was hardly entitled to so conspicuous a place, was the proposed division of the country into a maximum of twelve districts. It has been seen, too, that many who professed to be experts on banking, including among them not a few who afterwards became affiliated with the federal reserve system, had denounced this so-called "regional" plan as a wholly impossible and impracticable scheme. Finally, it will be recalled that one of the (subsequent) members of the Federal Reserve Board had himself taken pains to urge upon the members of the Banking and Currency committees of Congress the thought that if a regional division were actually to be employed it could not succeed unless the number of banks should be limited to four or perhaps five.

Point of Attack Chosen

Probably the most obvious point at which to attack the structure which had been developed for the federal reserve system was thus the actual districting of the country as solved upon. A survey of the field showed that there were two ways in which such an attack might be made. Appeals

might come from member banks in various sections of the country to the Board for transfers to other districts, and the Board might or might not act favorably upon these proposed transfers. On the other hand, the Board itself might, under the terms of the law—so it was supposed—act of its own motion to redistrict the country. The Federal Reserve law had given the Board the power to increase the banks up to twelve, should it find that the work of the Organization Committee in creating a smaller number of banks was not satisfactory. The fact that the Organization Committee had availed itself of its full powers and had even, thereby, perhaps anticipated some of the powers of the Board itself by establishing the whole number of twelve banks at the outset, was regarded by those who thought that redistricting should be effected, as an argument on their side rather than against the view that the Board had this power to change, consolidate, and generally alter the districting. It was the opinion of members of the Board, as well as of others, that the powers delegated to the Board would permit not only the shifting of district lines, but the elimination of districts through consolidation with others and the changing of the points at which the headquarters banks were to be located in the several districts.

Hostile Campaign Begun

With this assumption of powers and with this point of view, an effort to modify the structure of the system was definitely begun. The Board had not been in existence more than a very few weeks before much of the time at meetings came to be devoted to discussion of alleged difficulties growing out of variations of policy between the several districts, the apparent point of the discussion being to show that with so large a number of districts it would be impracticable or out of the question to bring about uniformity of policy. In connection with this attempt, effort was also made to show not only that the directorates of some of the smaller districts were weak, but that

they must necessarily always be weak because of the lack of capable men in those districts. This point of view could be sustained only upon the theory that the country's ability and thought had in some way become localized so that it could not be found in outlying regions away from the former financial centers, or perhaps upon the basis of a belief that these outlying regions could not or would not employ as operating officers men who came from a distance, but would insist upon employing only "local talent," which, being in scant supply, such banks would necessarily always be badly managed. Baseless as such arguments appear when stated in cold blood, long after the event, they were at the time of apparently urgent character, and the constancy and persistency with which they were pressed gave them an importance and reality which their content in no way justified. Of more importance was the recurrent contention that the outlying districts with the smaller capital were really unnecessary, and that if they could be consolidated with others better facilities would be provided for speedy collections, while far greater local strength would be developed.

Delay Due to War

Although these arguments were constantly urged in propaganda form through the first few months of the Board's life, a considerable time was necessary for them to take root or have much effect. There were several reasons for this state of affairs. In the first place, the European war with its attendant financial difficulties involved the nation and the banking system in the necessity of readjustments and new policies which necessarily took much of the time and energy, not only of the bankers of the country but of the Federal Reserve Board, during the first months of that body's career. Moreover, the currency had been greatly inflated, due to the emergency relief which had been afforded under the revised Aldrich-Vreeland Law during the early days of the war, and

the consequence of this situation was to necessitate much detailed work on the part of the Board in assisting banks to retire their outstanding notes and to make the necessary adjustments resulting from this contraction. Apart from all this, the mere physical labor of inaugurating the new system, preparing and issuing regulations for its governance, approving the internal organization of the banks, adjusting their salary lists, harmonizing relationships between directors, and generally carrying into effect the numerous practical matters of adjustment which were necessary from the outset, would fully have absorbed the time of the Board under the most favorable circumstances. The propaganda efforts referred to, therefore, did not take very strong hold until the late spring of 1915, when they began more and more to form the staple of discussion. During the summer and early autumn of that same year the controversy reached its high point of intensity, being urged forward by the expressed belief of members of the Federal Reserve Board that unless action were taken at an early date it would become ineffectual, due to the fact that as time went on it would be more and more nearly impossible to uproot any of the existing reserve banks, while during the succeeding year (1916) a presidential campaign would be under way and the proposal would be likely to become entwined with political controversy. Eventually the Board was induced to appoint a committee whose function it should be to examine into the whole question of redistricting, and a basis for this action was found in the fact that meanwhile certain of the petitions for the changing of district lines which had come before the Board were still pending there until such time as definite action could be taken upon them.

Basis of Redistricting Demand

It is now time to pause and consider the basis of the effort to redistrict the reserve system. Essentially, the change was

sought by those who were opposed to the loss of their early and exclusive prestige by the older financial centers and who would have gradually restricted the number of the reserve banks to four, or perhaps a smaller number. This object was, however, manifestly too difficult of attainment to be reached by any single step. It was therefore proposed by those who desired to alter the structure of the reserve system, to reduce the number of banks to either eight or nine, a process which would have involved the elimination of at least three banks and possibly four.

Practically, therefore, the question was twofold (1) that of marking certain reserve banks for disestablishment, and (2) that of redistributing their territory and effecting such necessary changes in the territory of the others as might be deemed essential. The logical first step in the task of selecting those banks was, however, that of determining what banks should necessarily be retained. Among such banks it was practically unanimously agreed that the institutions at New York, Chicago, and San Francisco were fundamentally essential and must be regarded as basic in any scheme that might be devised. In a second class, as banks which would at least be very difficult to eliminate, were those at Philadelphia, Boston, Cleveland, and St. Louis. With these was usually ranked the Richmond bank, not because of any fondness for that institution, but because of the belief that it had special protection which would enable it to resist all attack. This left the banks of Dallas, Kansas City, Minneapolis, and Atlanta. It was the feeling of some of those who were working upon the reconstruction problem that the Dallas and Kansas City territory could not well be combined with St. Louis, because of the enormous region which would thus be attached to the latter city, and that one or the other of these banks, or a new one in place of both, should be retained.

Ultimate Plan of Disestablishment

The plan for disestablishment thus reduced itself to the elimination of the banks at Atlanta, Minneapolis, and either Kansas City or Dallas, as the case might be. By some it was suggested that a proper measure of reformation would be that of locating a reserve bank at New Orleans with a large southwestern territory attached to it, this New Orleans bank to supersede Dallas, while much of the Kansas City territory would be divided between St. Louis and Chicago. This would have eliminated four banks—Dallas, Atlanta, Kansas City, and Minneapolis—while it would have established one new bank in New Orleans, leaving the eventual number at nine. The number nine was regarded as far too large and by some it was proposed that the St. Louis bank should also be disestablished, its territory to be in part assigned to Chicago and in part to the proposed New Orleans institution and in part divided among other districts. This plan would have left eight banks.

Among the more radical of those who desired to see the reconstruction process carried to its full limit, the idea prevailed that eventually the Richmond bank should be disestablished, thus reducing the number to seven, and probably dividing the Richmond territory between Philadelphia and Cleveland. That eventually Boston and Philadelphia would disappear, their territory being assigned to the New York bank, was predicted, although no one was courageous enough to urge such a change as an immediate plan, unless Boston bankers should prove willing to attach themselves at once to New York. The project thus looked forward to an eventual reduction, should the successive steps in the plan be effectively carried through from time to time, of the reserve banks to the original number of four or five. This, however, was for the future. The immediate step was that of disestablishing the banks at Atlanta and Minneapolis, and of securing the possible substitution of the proposed New Orleans bank in lieu of Dallas and Kansas City.

The committee to which the subject had been referred was, however, not wholly able to agree as to the precise measures to be taken, and formulated a series of tentative reports which were distributed among members of the Board for their consideration¹. It was probably in this way that news of the proposed change became disseminated among a small circle of outsiders. Secretary McAdoo had been closely occupied during the summer and early autumn of 1915 and had been able to attend the meetings of the Federal Reserve Board less frequently than during its early or formative months. He had not closely followed the progress of the movement for the disestablishment of certain banks. Possibly the fact that the plan was seriously under way was not appreciated by him until the latter part of September or the early weeks of October, 1915. As soon, however, as it became evident to him that the movement for the disestablishment of some of the banks was making progress, he began to take an active interest in the situation.

Views of Administration

The view of Mr. McAdoo was unmistakably that there should be no interference with the existing division into twelve banks, either by way of reducing the number or of changing the location of the headquarters banks. As has been seen in former chapters, it was largely to Mr. McAdoo himself that the selection of the several places as bank headquarters had been due. An alteration or modification of this plan was, therefore, necessarily a reflection upon his judgment. In addition, he undoubtedly felt the seriousness of the step which was proposed and recognized that if the number of banks could be reduced in the way suggested, there would be nothing to prevent its eventual further reduction and perhaps the final consolidation of all the banks into one, thus attaining the original purpose of the Aldrich bill and of other proposed measures.

¹ The final report of this series, written after the Attorney-General had ruled on the Board's powers, is furnished as Appendix A to this Chapter.

Unfortunately, Mr. McAdoo's interest in the situation had become seriously aroused only after the propaganda for reconstruction of the system had attained a very advanced stage, but upon looking into the conditions in the Board it seemed likely that he could not definitely be sure of more than two votes in addition to his own, the reconstructionists apparently having definite control of three votes with one doubtful, and likely to go their way on most issues. The case, therefore, was one which called for some finesse, since it obviously could not be met by direct ballot. Without waiting longer for the hostile element to perfect its plans, the Secretary in his capacity as Chairman called for a meeting at which the subject of reconstruction should be taken under advisement, and at this meeting strongly urged upon the Board the view that the action proposed involved serious legal questions, the answer to which ought not to be assumed or taken for granted, but on which an opinion of the highest legal authority should be obtained.

Attorney-General's Opinion

Although various hesitant opinions of the Board's counsel had been rendered as to different phases of the reconstruction question, Mr. McAdoo urged that the whole subject be transferred to the Department of Justice, there to be passed upon by the Attorney-General of the United States, both as to the question of the Board's power to reduce the number of districts and also as to its power to change the location of the reserve bank cities. It was with the greatest difficulty that the Board was induced to consent to this reference, but eventually the meeting ended in a close ballot which necessitated a call upon the Attorney-General for his opinion.

The formulation of the letter transmitting the case then became a matter of controversy in order that the language in which the reference was made might not contain any element of bias or suggestion. The terms of the letter having been ultimately agreed upon, it was sent to the Attorney-General,

and after the usual delay, due to elaborate consideration of the questions involved, an opinion was rendered on November 22.² Without pursuing the matter in its details, the decision of the Attorney-General was clear-cut and positive to the effect that the Board had no power either to reduce the number of banks or to alter the location of the reserve bank cities. Its powers, the Attorney-General found, were circumscribed and were limited, moreover, to the altering of district lines for the purpose of promoting the business and banking interests of the country. It was to the Organization Committee, said the opinion, that Congress had committed the function of developing the outlines of the system, the Board's power to create districts being contingent purely and having been, in fact, foreclosed by the fact that the Organization Committee had fully exercised its authority, leaving nothing for the Board in this connection to do.

Reconstruction Element Defeated

This positive opinion left the reconstruction element in the Board with practically nothing to fall back upon, since they did not possess a sufficient majority to override or disregard the opinion of the Attorney-General—always a serious step for an administrative body to take—while, on the other hand, investigation had shown that there was in the country at large no very definite or sustained opinion in favor of the proposed changes. The banks themselves whose disestablishment was proposed were already up in arms for the purpose of antagonizing the suggested innovation and had communicated with representatives in Congress. Not only a legal but a political struggle would manifestly have been precipitated by a genuine effort to disestablish a reserve bank, or even to cripple it by the transfer of the bulk of its territory to another institution.

² This opinion is reprinted in full in the Board's Annual Report for 1916, p. 128. It is also reprinted as Appendix B to the present chapter.

The Board at that time had no satisfactory following in Congress, the system being very generally regarded as on trial and having as yet had no opportunity to justify itself by any conspicuous services to the community. A thorough survey of the whole condition of affairs, therefore, furnished convincing proof that reconstruction efforts would fail, and that to carry them further would involve so serious an element of friction and so extended and bitter a controversy with the administration itself as to be practically out of the question. This also was doubtless the view of the financial interests which had been favorable to the efforts at reconstruction, and further discussion of the matter was, therefore, subsequent to the close of the year 1915, postponed by common consent to an indefinite future. What the framers of the act and the administration in general thought of the proposal was shown by a letter addressed by Chairman Glass to Mr. Delano but really meant for the Board as a whole.³

Actual Redistricting

The plan to alter the construction of the federal reserve system from inside thus failed of success. From the beginning, however, the question how far it should be altered through appeal from outside had been presented for careful consideration. We must therefore devote some attention to the various appeals for readjustment of federal reserve districts which were presented to the Board, and must consider briefly both the procedure by means of which they were dealt with and the theory upon which the conclusions were eventually arrived at. It has been seen in an earlier chapter that the work done by the Organization Committee in districting the country had been far from satisfactory. In consequence of it, a number of "sore spots" had early appeared. Some of these were genuine and were the result of unfortunate deci-

³ See Appendix C to this chapter

sions on the part of the Organization Committee. Others were purely artificial, the result of political prejudice or "worked up" opinion or sentiment. Of the places which had genuine grievances, that with the most effective arguments at its disposal was probably New Orleans. New Orleans, although a great seaport with a highly developed banking and commercial system and a large interior territory tributary to it, found itself attached to the Atlanta district and obliged to contribute its banking capital to the maintenance of the Federal Reserve Bank at Atlanta. Somewhat less evident, but very well defined, were the claims of Baltimore, which, although far more advanced in financial and industrial leadership than was Richmond, had been attached to the Richmond district in order to provide the necessary resources for the creation of the Fifth District.

A different kind of grievance was that of the banks in southern Connecticut, which had been included in the Boston district, notwithstanding that they were really a remote suburban part of Greater New York. So, likewise, many banks on the Jersey shore, Jersey City, Hoboken, and for some distance back from the coast, regarded themselves as really belonging to New York City and as only artificially to be assigned to Philadelphia. In a somewhat similar way certain banks in Wisconsin, formally assigned to the Minneapolis district, believed themselves to be really a part of the Chicago district in consequence of banking affiliation and transportation. In their opinion the northern line of the Chicago district had been erroneously drawn. Less clear-cut, but still possessing some color of justice, were the claims of certain Oklahoma banks included in the Dallas district, which desired to be transferred to Kansas City, and of some northern Louisiana banks which believed themselves properly assignable to the district in which was included the city of New Orleans, rather than to be assigned to the Dallas district.

A question of very much broader and very much less clear-cut merit was presented in the application of banks in Nebraska and Wyoming that they should be transferred to the Chicago district instead of being retained in the Kansas City territory. This request, if granted, would have seriously infringed upon Kansas City's banking support and would probably have necessitated various other rearrangements. Minor questions involving the boundary lines between districts also began to present themselves from the outset. Thus a few small banks in West Virginia had been erroneously assigned to Richmond when their real connection by sympathy and transportation communication was with Cleveland, and there were other points from which complaint was heard.

Principles of Readjustment

It was plain from the outset that the Board might adopt either a liberal or a narrow and technical view of these applications. It might regard as the fundamental principle of its action in redistricting, the establishing of a definite inconvenience or hardship resulting from assignment to a given district, or it might take the view that the fact that a given set of banks desired transfer from one district to another was *prima facie* reason for favoring their transfer unless some very good argument in opposition could be adduced, or unless the transfer of the banks would obviously result in greatly modifying the structure of the reserve system. It can hardly be said that the Federal Reserve Board ever directly and positively committed itself to either of these theories, but a review of the decisions, arrived at in the various appeals which were heard and determined by it, points to the conclusion that it was the narrower and more restrictive theory that was eventually adopted. This choice was the result of complex conditions. In the first place, it was seen at an early point in the discussion that if transfers were to be readily or freely per-

mitted, the number of applications for change would be greatly multiplied, due to the fact that there were always discontented banks in all sections of the country. This would have involved the Board in an enormously lengthy and detailed process of hearing appeals. On the other hand, those who desired to bring about a radical reconstruction in the federal reserve system were themselves disinclined on the whole to do much in the direction of granting local appeals for redistricting. They naturally thought that if their plans should succeed, much of this redistricting would be rendered unnecessary by virtue of the fact that the boundary lines complained of would in many cases be wiped out. On the other hand, they recognized that by granting appeals from banks in various sections of the country they in a measure committed themselves to the continued maintenance of such banks as members of the various districts to which they might be eventually assigned as a result of the Board's decision. Naturally, such commitments were purely of a moral character and could not be urged with any assurance of recognition or even as the outgrowth of a definite claim upon the Board, but an element of moral obligation was undoubtedly present in such cases and could hardly be ignored.

Influence of Banks

It would indeed have been a singular situation had the Board, after elaborately considering and eventually granting the application of certain banks to be transferred from one district to another, suddenly wiped out the boundary line between these two districts. Practically all elements in the Board, therefore, were thus at one in taking the view that the narrower attitude should be adopted in these decisions, and that the decisions should be reached only after the presentation of argument, very clearly showing, first, that a given change was almost unanimously desired by the banks in the region

which was to be shifted, and second, that such transfer could be effected without inconvenience or harm to either of the federal reserve banks involved in the operation. Adoption of this point of view considerably simplified the process of procedure in such appeals. The Board early resorted to the plan of requesting applicants for transfer to obtain from the other banks in the territory to be shifted, signatures or statements attesting that all desired the same thing. This both reduced the number of appeals on account of the fact that there was frequently very wide difference of opinion among local banks, and it also developed the latent opposition to various proposals which might otherwise not have come to the surface.

The method of procedure adopted was usually that of requiring the filing of argument or petition by representatives both of the banks desiring transfer and of the district from which transfer was proposed. A date was then set for hearing, and argument was presented by both sides. After duly considering the circumstances in the case and frequently after conducting a special inquiry of its own, the Board handed down an opinion, such opinion, when adverse, merely directing that further proceedings be discontinued, while when affirmative it took the form of an order entered upon the minutes of the Board and transmitted to the reserve banks affected by it. Such an order was merely a formal statement that banks in designated territory were to be shifted from one reserve district to another, and that the necessary return of stock in one reserve bank and the issue of the corresponding amount of stock in another should occur.

In all, the Board thus passed upon eight appeals, of which five were granted, the cases thus acted upon being as follows:

THE REDISTRICTING DECISION (Federal Reserve Bulletin)

Shortly after its organization, the Federal Reserve Board received petitions from banks located in several of the Federal reserve dis-

tricts, asking the transfer of designated portions thereof to other districts. These petitions were filed under section 1 of the Federal reserve act, which provides for an appeal from the decision of the Organization Committee to the Board, in the following language

As soon as practicable the Reserve Bank Organization Committee shall designate not less than eight nor more than twelve cities to be known as Federal Reserve cities, and shall divide the continental United States, excluding Alaska, into districts, each district to contain only one of such Federal reserve cities. The determination of said organization committee shall not be subject to review except by the Federal Reserve Board when organized. *Provided*, That the districts shall be apportioned with due regard to the convenience and customary course of business and shall not necessarily be coterminous with any State or States. The districts thus created may be readjusted and new districts may from time to time be created by the Federal Reserve Board, not to exceed twelve in all

The Board, recognizing the general desire for the establishment of the Federal reserve banks at as early a date as practicable, determined to defer the investigation and hearing of these petitions until a later date, announcing, however, that the action taken with reference to the banks would not prejudice the decision to be arrived at later, when the petitions should come up for definite determination.

When the first pressure of work attending the organization of the banks was over, dates were set for the hearing of the petitions, and during the months of January and February, 1915, all that had then been filed were heard by counsel. A detailed list of the dates set for the hearings and a statement of other facts relating to the proceedings were printed in the First Annual Report of the Board (p. 192). Subsequently the petition of certain banks in Tennessee for transfer from district No. 6 to district No. 5 was withdrawn, at least for the time being. This left the following cases pending before the Board:

(1) The petition of certain banks in northern New Jersey for transfer from district No. 3 to district No. 2.

(2) The petition of certain banks in West Virginia for the transfer of the counties of Wetzel and Tyler from district No. 5 to No. 4.

(3) The petition of certain banks in Oklahoma for transfer from district No. 11 to district No. 10.

(4) The petition of certain banks in Nebraska and Wyoming for transfer from district No. 10 to No. 7.

(5) The petition of the city of Baltimore to be designated as the headquarters of district No. 5 in place of Richmond, Va.

(6) The petition of the city of Pittsburgh to be designated as the headquarters of district No 4 in place of Cleveland, Ohio

Meantime, on March 13, certain banks in southern Wisconsin had filed a petition for transfer from district No 9 to district No 7, and still more recently, on May 10, certain banks in Connecticut filed a petition for transfer from district No 1 to district No 2. These last two petitions, however, were received at a time when the Board had either decided or was on the point of deciding the cases already presented. They were consequently not included in the action finally taken, but were reserved for later hearing and adjudication.

When the arguments and briefs relating to the petitions already enumerated were in hand, they were apportioned to committees of the Board. These committees reviewed the testimony and filed reports making recommendations with regard to the best method of disposing of the subjects referred to them. Action would then have been taken had it not been for the necessary absence of some members of the Board. This necessitated a postponement of action during the latter part of March and the whole of April. It was then voted to take definite action respecting the pending cases which had been heard at some time during the week beginning May 3. In accordance with this determination the Board on May 4 passed the following resolution:

Be it resolved, That the recommendations of the respective committees be adopted and approved, and that the petitions of the banks in southern Oklahoma, northern New Jersey, Tyler and Wetzel Counties, West Virginia, be granted, and,

Be it also resolved, That the petition of the banks of Wyoming and Nebraska be denied, and

Be it further resolved, That action on other pending petitions be deferred until further experience in the actual operation of the several districts, especially in the light of the new clearing system which is about to go into effect, and of the extent to which State banks take membership in the Federal reserve system, shall have provided the Board with the necessary data for a conclusion, it being the opinion of the Board that action on petitions relating to changes in cities designated as the location of Federal reserve banks should be deferred until the Board shall have reached a conclusion from experience as to any further readjustments in the boundaries of the several districts, or in the number of districts, which may be desirable in the operation and development of the Federal reserve system.

It will be seen that the Board in this decision denied one of the petitions—that of Nebraska and Wyoming—deferred action on two, those of the cities of Baltimore and Pittsburgh, for future consideration, and granted three, those of the banks of New Jersey, West Virginia, and Oklahoma.⁴

⁴ Those of the Wisconsin and Connecticut banks were subsequently likewise allowed

In order to make plain exactly what changes in the previous districts were made effective by the granting of these three petitions, the accompanying map has been drawn, and is herewith presented for the purpose of showing the boundaries of the twelve districts as they stand to-day. Inasmuch as the map is drawn upon too small a scale to admit of the clear representation of counties, there is hereto appended a list of counties in each of the States affected by the redistricting.

The names and capitalization of the banks in these transferred territories are likewise given.

NEW JERSEY

Counties Transferred to District No 2

Bergen	Middlesex	Somerset
Essex	Monmouth	Sussex
Hudson	Morris	Union
Hunterdon	Passaic	Warren

Counties Remaining in District No 3

Atlantic	Cape May	Mercer
Burlington	Cumberland	Ocean
Camden	Gloucester	Salem

OKLAHOMA

Counties Transferred to District No 10

Beckham	Haskell	McClain
Caddo	Hughes	Murray
Carter	Jackson	Pittsburg
Comanche	Jefferson	Pontotoc
Custer	Kiowa	Roger Mills
Garvin	Latimer	Stephens
Grady	Le Flore	Tillman
Greer	Love	Washita
Harmon		

Counties Remaining in District No 11

Atoka	Coal	Marshall
Bryan	Johnston	Pushmataha
Choctaw	McCurtain	

WEST VIRGINIA

In West Virginia the counties of Wetzel and Tyler were transferred from District No 5 to District No 4.

NEW JERSEY

List of Banks Transferred to District No 2

Name of bank	Location	Capital and surplus	Name of bank	Location	Capital and surplus
Farmers National	Allentown	\$100,000	Farmers & Merchants National	Matawan	150,000
First National	Arlington	81,000	Metuchen National	Metuchen	55,000
Seacoast National	Asbury Park	175,000	First National	Milford	45,000
Atlantic Highlands National	Atlantic Highlands	100,000	Do	Milburn	87,000
First National	Beleville	225,000	Essex National	Montclair	187,500
Do	Belmar	75,000	First National	do	150,000
Belvidere National	Belvidere	175,000	National Iron	Morristown	250,000
Warren County National	do	100,000	First National	do	400,000
Bernardsville National	Bernardsville	\$50,000	Citizens National	Netcong	50,000
First National	Blairstown	50,000	American National	Newark	375,000
Peoples National	do	75,000	Broad-Market National	do	270,000
Bloomfield National	Bloomfield	150,000	Essex County National	do	2,000,000
Citizens National	Bloomsbury	25,000	Manufacturers National	do	750,000
Boonton National	Boonton	200,000	Merchants National	do	1,000,000
Bound Brook National	Bound Brook	60,000	National Newark Banking Co	do	2,000,000
First National	do	125,000	National State Bank	do	750,000
Do	Bradley Beach	27,500	North Ward National	do	500,000
Do	Branchville	50,000	Union National	do	3,000,000
Do	Butler	110,000	National Bank of New Jersey	New Brunswick	500,000
Citizens National	Caldwell	41,000	Peoples National	do	250,000
Caldwell National	do	50,000	Merchants National	Newton	190,000
Califon National	Califon	31,000	Sussex National	do	400,000
Carlstadt National	Carlstadt	60,000	Ocean Grove National	Ocean Grove	50,000
Clinton National	Clinton	150,000	Orange National	Orange	300,000
First National	do	70,000	Second National	do	300,000
Do	Cranbury	150,000	Passaic National	Passaic	550,000
Closter National	Closter	50,000	First National	Paterson	1,100,000
National Union	Dover	375,000	Paterson National	do	600,000
First National	Dunellen	40,000	Second National	do	350,000
Do	East Newark	35,000	First National	Perth Amboy	300,000
Do	Eatontown	33,000	Phillipsburg National	Phillipsburg	500,000
Do	Edgewater	50,000	Second National	do	150,000
National State	Elizabeth	1,000,000	City National	Plainfield	300,000
Citizens National	Englewood	150,000	First National	do	300,000
First National	Englishtown	58,500			
Flemington National	Flemington	200,000			
Hunterton County National	do	200,000			
First National	Fort Lee	49,000			
Central National	Freehold	100,000			

NEW JERSEY—Continued

List of Banks Transferred to District No 2

Name of bank	Location	Capital and surplus	Name of bank	Location	Capital and surplus
First National	do	150,000	Rahway National	Rahway	150,000
National Freehold Banking Co	do	100,000	First National	Ramsey	45,000
Union National	Frenchtown	160,000	Second National	Red Bank	225,000
First National	Garfield	64,000	First National	Ridgefield Park	60,000
Do	Guttenburg	75,000	Do	Ridgewood	110,000
Hackensack National	Hackensack	200,000	Do	Rockaway	30,000
Peoples National	do	300,000	Do	Roosevelt	50,000
Hackettstown National	Hackettstown	250,000	Do	Roselle	65,000
Peoples National	do	100,000	Rutherford National	Rutherford	150,000
Hardyston National	Hamburg	85,000	First National	Sea Bright	32,500
First National	High Bridge	30,000	Do	Secaucus	25,000
Do	Hoboken	660,000	Do	Somerville	250,000
Second National	do	400,000	Second National	do	100,000
First National	Hope	32,000	First National	South Amboy	125,000
Irvington National	Irvington	145,000	Do	South River	125,000
First National	Jamesburg	75,000	Do	Spring Lake	75,000
Do	Jersey City	1,200,000	Do	Summit	100,000
Hudson County National	do	750,000	Farmers National	Sussex	200,000
Merchants National	do	250,000	First National	Tenafly	50,000
Keansburg National	Keansburg	27,500	Do	Town of Union	125,000
Peoples National	Keyport	60,000	Do	Washington	250,000
Amwell National	Lambertville	157,000	National Bank	Westfield	123,948
Lambertville National	do	200,000	Peoples National	do	80,000
Little Falls National	Little Falls	30,000	National Bank of North Hudson	West Hoboken	115,000
First National	Lodi	35,000	First National	West Orange	120,000
Citizens National	Long Branch	250,000	Do	Westwood	47,000
First National	do	150,000	Do	Whitehouse Station	47,000
Do	Lyndhurst	55,000	Do	Woodbridge	40,000
Do	Madison	85,000	Total		32,071,448
Manasquan National	Manasquan	75,000			

OKLAHOMA

Last of Banks Transferred to District No 10

Name of bank	Location	Capital and surplus	Name of bank	Location	Capital and surplus
The First National Bank	Ada	\$60,000	First National	do	110,000
Merchants & Planters National	do	60,000	First National	Lindsay	50,000
First National	Addington	26 722	Do	Lone Wolf	34,000
Do	Alex	45,000	Do	Mangum	75,000
Do	Allen	30,000	Mangum National	do	80,000
City National	Altus	54,500	First National	Marietta	75,000
First National	do	67,250	Marietta National	do	100,000
Do	Anadarko	60,000	The National Bank of	Marlow	29,200
National Bank of	do	30,000	State National	do	26,750
First National	Apache	30,000	Farmers National	Maysville	27,500
Do	Arapaho	30,000	First National	do	32,500
Ardmore National	Ardmore	120,000	American National	McAlester	125,000
First National	do	200,000	City National	do	55,000
State National	do	110,000	First National	do	135,000
First National	Berwyn	30,000	Do	Minco	30,000
Do	Bterr	29,000	Do	Mountain View	30,000
Do	Blanchard	50,000	Do	New Wilson	25,000
Calvin National	Calvin	28,000	Do	Okustee	30,000
First National	do	30,000	Do	Pauls Valley	150,000
The Chickasha National	Chickasha	113,500	National Bank of Commerce	do	60,000
Citizens National	do	90,000	Pauls Valley National	do	30,000
First National	do	260,000	First National	Poteau	42,500
Oklahoma National	do	125,000	National Bank of	do	60,000
First National	Clinton	35,000	The Chickasaw National	Percell	75,000
Oklahoma State National	do	27,750	Union National	do	33,000
First National	Comanche	30,000	First National	Quinton	30,000
Cordell National	Cordell	35,000	Do	Ringling	50,400
Farmers National	do	28,500	Farmers & Merchants National	Roff	37,500
State National	do	33,500	First National	do	36,000
First National	Custer City	30,000	Do	Rush Springs	36,000
Peoples State National	do	30,000	Do	Ryan	60,000
First National	Davis	60,000	Beckham County National	Sayre	27,500
City National	Duncan	42,000	First National	do	32,500
Duncan National	Duncan	50,000	Do	Sentinel	27,500
First National	do	60,000	Do	Snyder	27,500
Do	Eldorado	40,000	Do	Spiro	20,000
Do	Elk City	56,000	American National	Stigler	30,000
Francis National	Francis	30,000	First National	do	60,000
First National	Frederick	72,000	Do	Stonewall	42,000
National Bank of Commerce	do	90,000			

OKLAHOMA—Continued

List of Banks Transferred to District No 10

Name of bank	Location	Capital and surplus	Name of bank	Location	Capital and surplus
First National	Gotedo	27,700	Do	Stratford	27,500
Do	Grandfield	30,000	Do	Stuart	29,000
Farmers National	Hammon	27,650	Park National	Sulphur	30,000
First National	Hartshorne	75,000	First National	Tahhna	26,250
National Bank of	Hastings	28,500	Temple National	Temple	27,500
First National	Heavener	31,000	First National	Thomas	30,000
State National	do	25,000	First National	Verden	26,500
City National	Hobart	33,500	National Bank of	do	30,000
Farmers & Merchants National	do	60,000	First National	Walters	30,000
First National	do	30,000	Walters National	do	40,000
American National	Holdenville	30,000	First National	Washington	26,000
Farmers National	do	27,500	Do	Waurika	27,650
First National	do	30,000	Waurika National	do	25,500
City National	Hollis	25,500	First National	Weatherford	28,500
National Bank of Commerce	do	30,000	German National	do	60,000
State National	do	25,000	American National	Wetumka	30,000
Farmers National	Hydro	25,050	First National	do	35,500
First National	do	27,500	Latimer County National	Wilburton	29,000
Keota National	Keota	28,500	First National	Wynnewood	100,000
First National	Kiowa	36,000	Southern National	do	80,000
Peoples National	do	27,500	Total		5,994,873
City National	Lawton	100,000			

WEST VIRGINIA

List of Banks Transferred to District No 4

Name of bank	Location	Capital and surplus	Name of bank	Location	Capital and surplus
First National	Middlebourne	\$39,500	First National	Sistersville	165,000
Do	New Martinsville	75,000	Peoples National	do	115,000
Farmers and Producers National	Sistersville	136,000	Total		530,500

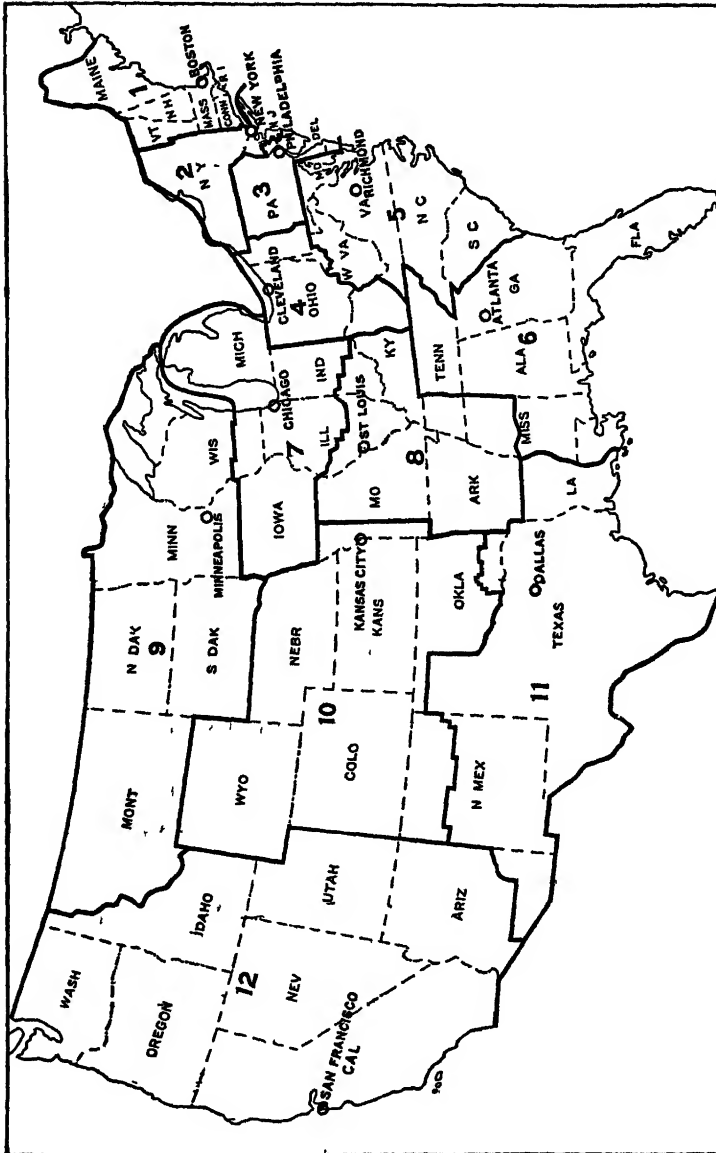
The pending cases divide themselves into two broadly distinguishable classes, the one involving extensive revision of the work already done and requiring for its elucidation and proper determination knowledge which could come only from experience and observation of the actual working of the several Federal reserve banks, the other involving simpler and less extensive interests and requiring less detailed information as to the whole problem of districting.

The Board's announcement on the whole subject, while going as far as it has been deemed practicable under existing conditions to take action, is not at all to be regarded as final and was not intended to be so. The right to act further on the matter is reserved for future exercise as that may be necessary and at any time. Although there has been no express statement to that effect, it is a clear inference from the opinion handed down that future action will depend very much upon the course of events in the districts as they are now made up, and will be determined by the conditions that are disclosed in the operations of the banks.

As a result of the favorable action in the appeals thus noted, the outlines of the reserve system were slightly changed at several points, the map of the system eventually assuming its final form about the middle of 1916, as shown on page 749.

Net Result of Minor Import

That this process of reconstruction had only in the slightest and most elementary way affected the districting that had originally been done by the Organization Committee, is thus evident. Judged either by the amount of territory or by the number of resources of banks transferred from one district to another, the alterations introduced into the decisions of the Organization Committee were trifling. The opinion of the Attorney-General practically foreclosed the Board from making far-reaching or essential changes in the structure of the system, while its own recognition of the futility of sapping the strength of one bank—the total number being presupposed stable—simply to increase that of another, prevented it from exercising even the full scope of its powers within the limits which the Attorney-General had recognized as belonging to it.



Map showing Federal Reserve Districts, with Changes by Federal Reserve Board

As the development of the system proceeded and as the working out of the Board's branch policy became better and better recognized and determined, the banks of the country came more and more fully to admit the unimportance of the district lines. It was, in fact, a matter of only technical and local significance whether a given bank was or was not attached to a given district. What was essential was the maintenance of a considerable number of the districts themselves and their general correspondence with the several producing districts of the country, the object being to obtain, so far as practical, banking decentralization and at least the opportunity of independent control by the smaller local institutions. The effort to reconstruct the federal reserve system, whether from the inside or the outside, was thus only a flash in the pan—a fresh effort of the interests which had been hostile to the "regional" type of organization, to bring about by this means a restoration of the central banking method of organization. Unable to succeed in the attainment of their object by this means, they naturally turned to other methods.

APPENDIX A TO CHAPTER XXXIV

FEDERAL RESERVE BOARD COMMITTEE REPORT ON REDISTRICTING

December 2, 1915

To the

Federal Reserve Board

Your Committee on Redistricting has received and noted the copy of the opinion of the Attorney General addressed to The President of the United States, under date of November 22, 1915, to the effect that the Federal Reserve Board has not the power to abolish any one or more of the Federal Reserve districts, or any one or more of the Federal Reserve Banks located in the cities designated by the Reserve Bank Organization Committee.

Your Committee feels that there has been a serious misunderstanding, not only of the substance and purpose of its preliminary report filed with the Board on November 13, 1915, but also of the motives which prompted it. Therefore, before making any further

recommendations, your Committee is desirous of recounting briefly the facts which led to its action and on which it based its recommendations, with the hope that a better understanding of the facts as they appeared to your Committee may promote a common point of view and conduce to a continuation of the harmonious cooperation and mutual good will that has in the past characterized the work of the Board and stamped it with the approval of the public at large

On March 1, 1915, Mr Elliott filed with the Board an opinion dealing with the general powers of the Board to review the determination of the Organization Committee, to readjust the Federal Reserve districts, to change the designation of the Federal Reserve cities, and to reduce the number of districts formed by the Organization Committee. It is to be noted, however, that, in this opinion, the question of reduction was referred to very briefly, and Mr Elliott later advised the Board that the consideration of this particular question was merely incidental to the main questions discussed in that opinion and that, should the question of reduction be specifically considered by the Board, he would appreciate an opportunity of reconsidering his earlier opinion on that particular point

In view of the doubts raised by Mr Elliott, members of the Board availed themselves of the opportunity of Senator Owen's appearance before it in the hearing of the appeal of certain Oklahoma banks requesting a transfer from the Dallas to the Kansas City District, to ask for his views concerning the intent of Congress and the meaning of the Federal Reserve Act relating to the powers of the Board on this whole subject. The request for Senator Owen's views was not accidental, but intentionally contemplated to instruct and guide the Board in disposing of pending appeals. His answer was that Congress meant to "give to the Board the power of the Government itself in dealing with this system" and that he thought the power of the Board "would extend even to the power of reducing the districts"

It is understood, of course, that this statement by Senator Owen was merely his own personal opinion and that it was made at a time when another though closely related subject was under consideration, but it at least indicates that there was no decided impression in Senator Owen's mind that this power to reduce was not given the Board

The Board subsequently published in the June 1, 1915, Bulletin, a resolution, which was passed unanimously on May 4, 1915, when both Governor Hamlin and Mr Williams were present, providing, among other things, as follows

That action on other pending petitions be deferred until further

experience in the actual operation of the several districts, especially in the light of the new clearing system which is about to go into effect and of the extent to which State banks take membership in the Federal Reserve System, shall have provided the Board with the necessary data for a conclusion, it being the opinion of the Board that action on petitions relating to changes in cities designated as the location of Federal reserve banks should be deferred until the Board shall have reached a conclusion from experience as to any further readjustments in the boundaries of the several districts, *or in the number of districts which may be desirable in the operation and development of the Federal Reserve System* (The italics are ours)¹

Your Committee is positive that no objection was raised at that time by any member of the Board or by any Member of Congress, indicating dissent from the proposition that the Board had the right to reduce the number of districts. Indeed, such an argument was never raised in the briefs of counsel on the various appeals heard by the Board.

On October 19, 1915, the following vote was passed, "to refer the question of *redistricting* to a special Committee consisting of Mr Delano, Mr Harding and Mr Waiburg." Counsel for the Board were soon thereafter requested to prepare opinions as to the legal right of the Board to reduce the number of districts. Mr Cotton filed his formal opinion on November 22, 1915, stating unqualifiedly that the Federal Reserve Board is fully authorized by the Act to reduce the number of districts. Mr Elliott, who, in accordance with his own request, was reconsidering his earlier opinion of March 1, 1915, filed his opinion with the Governor on November 23, 1915, and on November 22, 1915, the Attorney General delivered his opinion addressed to The President.

It may be noted, therefore, that at the time of making its preliminary report on November 13, 1915, your committee did not believe either that members of Congress would take the position that the Board was without power to reduce the number of districts or that members of the Board would, in view of the unanimous resolution above quoted, take that view unless forced to adopt it by the conclusive opinion of Counsel.

Your committee began its work by elaborating a report submitting definite alternative plans, but finally concluded that it would be preferable to ask the Board first to pass upon the question of policy and the principle involved. Your committee had, however, reached a conviction that the country would be better served by a reduction in the number of districts to eight or nine. The reasons on which this

¹ That is to say, the committee's

conviction was based seemed so convincing and conclusive to the committee that it hoped the Board might adopt unanimously the recommendation which it outlined. The committee is desirous of emphasizing in the strongest terms its absolute confidence, not only in the underlying principles of the Federal Reserve Act, but also in the machinery provided for developing such principles into a system which has already brought immeasurable benefits to this country and which, whether with twelve banks or eight, will prove of inestimable value. That the number of banks and districts originally created was larger than is conducive, in the opinion of your committee, to the most efficient operation of the system and to the greatest safety of the country is not the fault of the Act, but is due to the fact that the Organization Committee, which, though acting in the best of faith could not, in the short time allotted to it, acquire such knowledge and experience as is absolutely necessary to a final determination of such an important question.

The Attorney General has since denied the right of the Board to reduce the number of districts determined by the Organization Committee, and in view of that your committee is not desirous of making any further recommendations at this time. It wishes, however, to emphasize the fact that at the time of filing its preliminary report, no doubt existed in its mind as to the wisdom of reducing the number of districts in the near future, but also the right of the Board to make such a reduction.

Your committee is ready to submit an abstract of the arguments that were prepared by it when it supposed that the subject was to be discussed on its merits, and it is of the opinion still that these arguments will assert themselves sooner or later, and that the country will not rest satisfied until the Federal Reserve System shall have been developed to render its maximum possible efficiency. Furthermore, your committee feels that, if the adjustment is not made at this time, it more than likely to be made at some future time, but with far greater difficulty and disturbance.

In reviewing the evidence before the Organization Committee it was noted that, of the eighty-four witnesses, only nine recommended the formation of twelve districts, a large majority favoring not to exceed nine districts.

Your committee concluded, as a result of its study of the question, that the greatest protection from future disturbance was the immediate establishment of a system enjoying its maximum degree of usefulness and service. The country would not permit any subsequent interfer-

ence with a machinery once perfected, whereas, weaknesses, such as those which seemed to your committee to exist now, offer a constant target for critics. For these reasons, not to mention the many practical advantages incident to carrying out, prior to January 1, 1916, any changes that might have been decided upon by the Board, your committee was sincerely anxious to secure prompt discussion and full consideration of its recommendations.

As the chairman of the Committee repeatedly stated, the desire for immediate consideration of the question was not prompted by any intention on the part of your committee to force the Board to take any unconsidered action, and the fact that the request of two members of the Board for another preliminary report in writing as to the reasons for its recommendations was opposed by the committee was, as explained by the committee, solely because it desired to have the report discussed on its merits without delay and at that time lay before the Board all the facts and figures it had collected. Such a course was in consonance with our usual practice.

The Committee had postponed filing its report on account of Secretary McAdoo's absence in the west, and later waited until Mr. Harding had called on him at his house to apprise him informally of the views of the committee and secure any suggestions which he might see fit to make. The Secretary, however, was unable, because of his own illness, and later by illness in his family, to discuss the matter with Mr. Harding, and the committee then filed its report on Saturday, November 13, 1915, fixing the following Monday for discussion by the full Board, the Secretary of the Treasury having stated to members that he would be engaged on his report to Congress until the 15th, which the committee assumed would leave him free after that date. However, consideration of the report was postponed until Monday, November 22, 1915, because of the inability of the Secretary of the Treasury to be present until that date.

At the meeting of November 22d, the opinion of the Attorney General, already referred to, was presented, also, the letters of two United States Senators. Your Committee desired to repeat that at no time had there been a discussion of the Committee's original report of November 13th or of the revised report of November 17th. The Committee therefore regrets that before it had the opportunity which it desired to make an oral presentation of facts and arguments, and various data, in its possession, the Attorney General's opinion was sought without its knowledge.

Your Committee believes that it would have been fairer to the

President, to the Attorney General, and to the Federal Reserve System, if the case had been submitted to the Attorney General with a full presentation of arguments on both sides of the question. If the Attorney General, for example, had understood that no closing of banking offices was contemplated but that in every city where a Reserve Bank was abandoned a branch bank would be established, he would not have been led to believe that the Committee's recommendation "would profoundly affect the currents of trade and alter the whole face of business throughout vast sections of the country," etc.

If your Committee was right in its conclusions as to the advisability of a smaller number of districts, the permanency which the Attorney General and every one of us desires for the future of the system would have been best secured by prompt and courageous action now.

Your Committee, however, fully appreciates the authority of the Attorney General's opinion and, submitting to the conclusions reached therein, recommends that the Board abandon, at least for the present, any plan of redistricting which involves the consolidation of any districts and that the Board now addresses itself to the specific appeals pending and to such readjustments as may be permissible and practicable under the Attorney General's opinion.

There are now pending before the Board for disposal five applications, viz

First The application of certain member banks located in Western Connecticut requesting that the territory in which they are located be transferred from the First to the Second Federal Reserve District. The Committee respectfully recommends that a date be fixed for the hearing of oral arguments before the Board relative to this appeal,

Second The application of certain member banks located in Wisconsin requesting that the territory in which they are located be transferred from the Ninth to the Seventh Federal Reserve District. The Committee respectfully recommends that the Board send a letter ballot to all member banks of the Minneapolis District involved in this appeal, requesting that they reply promptly to the Federal Reserve Board, stating whether they wish to be transferred to the Seventh or to remain in the Ninth District, and stating also whether they feel that their interests are being harmed by remaining in the Ninth District,

Third The application of certain member banks located in

Louisiana requesting that the territory in which they are located be transferred from the Eleventh to the Sixth District. The Committee respectfully recommends that, unless the Federal Reserve Bank of Dallas desires to be heard in the matter, the case of the Louisiana banks be decided upon the facts now in the possession of the Board without any further hearing, but if Dallas desires to be heard that a date for the hearing be promptly fixed.

Fourth The application of member banks located in
and

Fifth Pittsburgh and Baltimore requesting that those cities be designated as Federal Reserve Cities in place of Cleveland and Richmond, respectively.

Your Committee wishes to call the Board's attention to the opinion of Mr. Elliott, dated March 1, 1915, which, in answer to the question, "Can the Federal Reserve Board, under the terms of the Federal Reserve Act, designate other Federal Reserve Cities in place of those selected by the Organization Committee?" held that the Board has no legal power to change the designation of a Federal Reserve City unless such change is necessary in order to accommodate the convenience and customary course of business in a readjusted district. Mr. Elliott, in disposing of this point, stated:

If, therefore, the Board concludes that the districts are not apportioned according to the purpose and intent of the Act and determines that it is necessary to readjust such district, it would seem clear that it possesses an implied power to change the designation of the Federal reserve cities. If, however, the districts are not readjusted, it seems very doubtful whether this power can be implied, and to change the designation of cities without readjusting the districts would necessitate resolving this doubt in favor of the exercise of this power against the apparent intent of Congress.

On the strength of this opinion of its Counsel, the Board might well be justified in undertaking such changes in the designation of Federal Reserve Cities as may be necessarily incident to the readjustment of the districts in which they are located. On the other hand, in view of the great importance of the subject, and because of the doubt expressed by Mr. Elliott, and also because of the uncertainty in the minds of the Committee as to the intent and effect of the opinion of the Attorney General on this particular point, it submits for consideration of the Board the suggestion that the Governor be instructed to address a letter to the President, asking him kindly to request the Attorney General to give his opinion on the following questions.

- (1) Can the Federal Reserve Board legally change the present location of any Federal Reserve Bank?
 - (a) In the case where there has been no alteration in the district lines? and
 - (b) In the case where there has been such a readjustment of district lines as in the opinion of the Board necessitates the designation of a new Federal Reserve City in order that the convenience and customary course of business may be accommodated as required by law?
- (2) Must the Board, in exercising its admitted power to readjust, preserve the \$4,000,000 minimum capitalization of each and every Federal Reserve Bank?

Your Committee finds itself unable to make any specific recommendation relating to the changes in the designation of the cities of Cleveland and Richmond as Federal Reserve Cities in the Fourth and Fifth Districts, respectively, but it feels that any attempt to determine those questions should be deferred until the Board is advised finally and definitely, not merely of its power to change the designation of a city, but also, first, whether the power to make such a change is dependent upon further readjustments in the district lines, and, second, whether, if it is dependent upon such readjustments, the \$4,000,000 capital limit must be preserved in making such changes in the district lines.

Your Committee also feels that if this matter is put up to the Attorney General, he should be advised that, while there are distinct features in the present adjustment of districts which do not commend themselves to the best judgment of the Committee, and do not in its opinion comply strictly with the injunction that due regard must be had to the convenience and customary course of business, we recognize the difficulty of adjusting these matters so long as the Board is bound to preserve twelve districts, and at the same time maintain for each bank a capital large enough to command sufficient prestige and confidence.

In his opinion the Attorney General formulated the query, "Would the power to readjust districts, which is expressly conferred upon the Board, be nullified or rendered impotent if the power to abolish districts and banks is withheld?" Your Committee's response to this is that the ruling of the Attorney General, as a practical matter, nullifies the Board's power to readjust the districts inasmuch as such readjustment of necessity must be made with a view to preserving an adequate

capitalization for each bank, several of which are now close to the limit prescribed for the Organization Committee and of smaller size than is conducive, in the opinion of your Committee, to the best interests of the system

Respectfully submitted:

F A DELANO

P M WARBURG

W P G HARDING

Committee

APPENDIX B TO CHAPTER XXXIV

OPINION OF ATTORNEY-GENERAL AS TO REDISTRICTING

DEPARTMENT OF JUSTICE,

Washington, April 14, 1916

SIR At the request of the Federal Reserve Board, you have submitted the following questions for my opinion

I Can the Federal Reserve Board legally change the present location of any Federal Reserve Bank

(a) In the case where there has been no alteration in the district lines, and

(b) In the case where there has been such readjustment of district lines as in the opinion of the Board necessitates the designation of a new Federal Reserve city in order that due regard may be given to the convenience and customary course of business as required by section 2 of the Federal Reserve Act?

II Must the Federal Reserve Board, in exercising its admitted power to readjust, preserve the \$4,000,000 minimum capitalization required of each Federal Reserve Bank as a condition precedent to the commencement of business?

I

In my opinion of November 22, 1915, I expressed the view that the Federal Reserve Act does not confer on the Federal Reserve Board the power to abolish any of the existing Federal Reserve Banks or Federal Reserve districts I believe that the reasoning of that opinion is equally applicable to both branches of the first question now submitted

Section 2 of the Federal Reserve Act provides

"As soon as practicable, the Federal Reserve Bank Organization.

Committee shall designate not less than eight nor more than twelve cities to be known as Federal Reserve cities, and shall divide the continental United States into districts each district to contain only one of such Federal Reserve cities. The determination of said organization committee shall not be subject to review except by the Federal Reserve Board when organized. *Provided*, That the districts shall be apportioned with due regard to the convenience and customary course of business and shall not necessarily be coterminous with any State or States. The districts thus created may be readjusted and new districts may from time to time be created by the Federal Reserve Board, not to exceed twelve in all. Such districts shall be known as Federal Reserve districts and may be designated by number.

"Said organization committee shall be authorized . to make such investigation as may be deemed necessary by the said committee in determining the reserve districts and in designating the cities within such districts where such Federal Reserve Banks shall be severally located."

The same section further provides

"The said committee shall supervise the organization, in each of the cities designated, of a Federal Reserve Bank, which shall include in its title the name of the city in which it is situated, as 'Federal Reserve Bank of Chicago'."

Since the Act thus provides that each city designated as a Federal Reserve city is to be the location of a Federal Reserve Bank, it follows that a change in the location of a Federal Reserve Bank would in effect be the designation of a new Federal Reserve city and the abandonment of one previously designated. I find no more warrant in the Act for the abandonment of one Federal Reserve city and the designation of a new one than I do for the abolition of a Federal Reserve district when once established.

The power to designate a new Federal Reserve city (12 cities having been named by the Organization Committee) or to change the location of a Federal Reserve Bank is not expressly conferred by the Act on the Federal Reserve Board. If the Board possesses such power, it is only by implication from the provision that—

"The determination of said Organization Committee shall not be subject to review except by the Federal Reserve Board when organized. *Provided*, That the districts shall be apportioned with due regard to the convenience and customary course of business and shall not necessarily be coterminous with any State or States. The districts thus created may be readjusted and new districts may from time to

time be created by the Federal Reserve Board, not to exceed twelve in all "

In my opinion there is no clear indication, either in the provision just quoted or elsewhere in the Act, of an intent to confer on the Federal Reserve Board the power to change the location of Federal Reserve Banks by the designation of new Federal Reserve cities. On the contrary, there are indications of an opposite intent. As stated in my opinion of November 22, 1915, above referred to, "the merely negative statement that the determination of the Organization Committee shall not be subject to review except by the Federal Reserve Board when organized clearly can not be enlarged into an affirmative grant of power to the Board to review and set aside everything done by the Organization Committee. The reasonable view is that by that language Congress meant that the determination of the Organization Committee should not be subject to review at all, except in so far as the subsequent provisions specifically authorize a review by the Federal Reserve Board. The only subsequent provision authorizing a review of the determination of the Organization Committee by the Federal Reserve Board is contained in the sentence, 'The districts thus created may be readjusted and new districts may from time to time be created by the Federal Reserve Board, not to exceed 12 in all' "

Again, as stated in that opinion, "a reading of the Act shows at once that the Organization Committee was created not merely for the purpose of attending to the formalities of organization or to serve as a stop-gap until the Federal Reserve Board should come into existence, but that it had an independent function to perform and to that end was invested with wide powers. That is to say, its function was to organize the system as contradistinguished from the function of the Federal Reserve Board, which was primarily to administer the system "

The duty of designating Federal Reserve cities belonged to the Reserve Bank Organization Committee as a part of the organization of the system, and the committee was required by the Act to designate not less than 8 nor more than 12 cities. This duty is named first among those imposed upon the Organization Committee, and it is imposed by the same provision of section 2 which required the committee to divide the United States into Federal Reserve districts. The same considerations that indicate an intention that the several districts should be permanent would also indicate that the designation of the cities was not to be made for temporary purposes, but was intended to be permanent, subject, of course, to change by Congress. The designation was to be made only after thorough investigation, and

the same machinery was provided to facilitate both the determination of the districts and the designation of the cities. Thus, section 2 provides

"Said Organization Committee shall be authorized to employ counsel and expert aid, to take testimony and to make such investigation as may be deemed necessary in determining the reserve districts and in designating the cities within such districts where such Federal Reserve Banks shall be severally located."

In my opinion, this coupling of the duty of determining the districts with the duty of designating the Federal Reserve cities within the several districts shows an intention on the part of Congress that the cities so designated are to constitute the fixed centers in the scheme or system of division, the duty of designating the cities being coordinate with the duty of forming districts around them. It was left to the discretion of the Organization Committee whether it should designate the full number of Federal Reserve cities and establish the full number of Federal Reserve districts permitted by the Act. The committee elected to designate and establish the full number authorized, thereby practically suspending the operation of the provision of the Act that "new districts may from time to time be created by the Federal Reserve Board not to exceed 12 in all." The primary if not the only purpose of that provision must have been to take care of the situation in the event that the Organization Committee had designated less than 12 Federal Reserve cities.

The fact that the Federal Reserve Board, aside from the provision relating to the creation of new districts from time to time, was merely given the power to readjust districts suggests that there was to be some permanent characteristic or element in the districts created by the Organization Committee. If, however, in addition to the power which the Federal Reserve Board has of readjusting districts by changing their boundary lines, it also possessed the power to change the location of the respective Federal Reserve cities within such districts, then the Board could, by successive changes of cities and boundaries, entirely obliterate existing districts and substitute in their place new districts totally different from those created by the Organization Committee. I do not think that Congress intended to confer such a power.

The Act provides that each Federal Reserve Bank is to include the name of the city in which the bank is located. By section 4 it is provided that the organization certificate of each bank shall state specifically—

"The name of such Federal Reserve Bank, the territorial extent of the district over which the operations of such Federal Reserve Bank are to be carried on, the city and State in which said bank is to be located, the amount of capital stock, and the number of shares into which the same is divided"

. . .

When the minimum amount of capital stock required for the organization of any Federal Reserve Bank shall have been subscribed, the Organization Committee is directed to designate any five of the subscribing banks to complete the organization and to execute and file with the Comptroller of the Currency a certificate of organization, stating the name of such Federal Reserve Bank, the city and State in which it is located, the territorial extent of the district in which its operations are to be carried on, the amount of its capital stock and the number of shares into which the same is divided, the name and place of business of each bank executing the certificate of organization and of each subscribing bank and the number of shares subscribed by each, etc (sec 4)

Upon the filing of this certificate such Federal Reserve Bank becomes a body corporate, with the powers which are enumerated, amongst them the power—

"to have succession for a period of twenty years from its organization unless it is sooner dissolved by an act of Congress, or unless its franchise becomes forfeited for some violation of law" (sec 4)

Acting under the authority of these provisions, the Organization Committee divided the country into 12 Federal Reserve Districts and designated in each a Federal Reserve city. Boston was designated as the Federal Reserve city for district No 1, New York for district No 2, Philadelphia for district No 3, Cleveland for district No 4; Richmond for district No 5, Atlanta for district No 6, Chicago for district No 7, St Louis for district No 8, Minneapolis for district No 9, Kansas City for district No 10; Dallas for district No 11, San Francisco for district No 12. A certificate to that effect was filed on April 2, 1914, in the office of the Comptroller of the Currency.

A Federal Reserve Bank was duly organized at each of these cities. On May 18-20, 1914, all filed their certificates of organization and thereby became bodies corporate with the rights and powers enumerated in section 4 of the Act. Their organization was officially announced by the Secretary of the Treasury, pursuant to the second paragraph of section 19 of the Act, and on November 14, 1914, pur-

suant to section 4 of the Act, they were authorized by the Comptroller of the Currency to commence business

They have been engaged in business for a little over a year Their statement for the week ending November 12, 1915, shows their capital, deposits, and total resources, as follows

Federal Reserve Bank of—	Capital	Deposits	Resources
Boston	\$ 5,171,000	\$ 22,218,000	\$ 28,615,000
New York	11,059,000	181,710,000	196,544,000
Philadelphia	5,273,000	19,933,000	25,206,000
Cleveland	5,945,000	18,556,000	24,501,000
Richmond	3,352,000	*13,160,000	21,669,000
Atlanta	2,417,000	*11,268,000	16,629,000
Chicago	6,635,000	49,993,000	56,628,000
St. Louis	2,778,000	11,204,000	13,982,000
Minneapolis	2,495,000	10,425,000	12,920,000
Kansas City	3,027,000	9,826,000	14,080,000
Dallas	2,753,000	*11,992,000	18,671,000
San Francisco . . .	3,941,000	14,032,000	17,973,000
Total	54,846,000	374,317,000	446,192,000

* Includes Government deposit of \$5,000,000

All of them have issued Federal Reserve notes, of which at present time \$160,000,000 in round figures are outstanding

One has purchased a site for its bank building, and the others have leased quarters for long terms

The question is, Has the Federal Reserve Board the power to *abolish* any of the existing Federal Reserve Districts established by the Organization Committee as hereinabove described?

As there can be only one Federal Reserve Bank in a district, a district can not be abolished without abolishing a bank Therefore, inseparably linked with the question first stated is the further question, Has the Federal Reserve Board the power to *abolish* a Federal Reserve Bank?

And since, concededly, the power to *abolish* a Federal Reserve District or a Federal Reserve Bank is not granted in express terms, the question finally becomes, Is it to be implied from other provisions of the Act that Congress intended to confer that power?

The Counsel of the Board held not, in an opinion dated March 1, 1915 Subsequently, Mr Joseph P Cotton, of New York, was consulted, and he reached the opposite conclusion in an opinion dated November 19, 1915

The Federal Reserve Banks are not banks in the ordinary sense. They are banks composed of banks. They touch the business life of the Nation in its most sensitive spot. Of all the processes of business, theirs is perhaps the most delicate.

In determining whether Congress intended by implication to confer upon the Federal Reserve Board power to abolish one or more of these institutions, it is proper to consider that if the power exists at all it may be exercised not only now, but at any time in the future. Certainly it was the expectation of Congress that the Federal Reserve Banks would extend their roots deep, that upon them as a foundation permanent banking arrangements better than any we have ever known would be constructed, and that they would become interwoven with the business fabric of the country.

If these expectations shall be realized, and in this discussion we must assume that they will be, the abolition of one or more of the Federal Reserve Districts, and consequently of one or more of the Federal Reserve Banks, whether for better or for worse, would profoundly affect the currents of trade and alter the whole face of business throughout vast sections of the country, to say nothing of the effect upon the investments of member banks and perhaps of the public in the capital stocks of reserve banks.

It must be acknowledged that the power to do such a thing is, to borrow a phrase of the Supreme Court, "a power of supreme delicacy and importance", and I am of the opinion that the failure to confer such a power in express terms would be regarded by the courts as virtually conclusive that Congress did not intend it to be exercised except by itself.

A leading case in point is *Interstate Commerce Commission v. Railway Co* (167 U. S., 479). There the question was whether the Interstate Commerce Commission, when it found a particular rate to be unreasonable, was given the power by the act to regulate commerce as originally enacted to prescribe what should be a reasonable rate for the future. As in the present instance, the power in question was not expressly given, but the commission claimed that it had the power by necessary implication.

Briefly stated, its contention was, that it was expressly charged with the enforcement and execution of the provisions of the act, that amongst other provisions was section 1 which required all charges to be reasonable and just and prohibited every unjust and unreasonable charge, that in the nature of things it could not enforce this mandate of the law without a determination of what are reasonable and just

charges, and finally, since no other tribunal was created to make that determination, it must be implied that the commission was authorized to do so (167 U S , 500, 501)

The court, overruling this contention, held that as the act did not expressly grant the power the commission did not possess it Speaking through Mr Justice Brewer, the court said

"The question debated is whether it (Congress) vested in the commission the power and the duty to fix rates, and the fact that this is a debatable question, and has been most strenuously and earnestly debated, is very persuasive that it did not The grant of such a power is never to be implied" (494)

Again, it refers to—"the inference which irresistibly follows from the omission to grant in express terms to the commission this power of fixing rates" (506)

And again—"The vice of this argument is that it is building up indirectly and by implication a power which is not in terms granted" (509)

Still again—"And if it (Congress) had intended to grant the power to establish rates, it would have said so in unmistakable terms" (509)

Whilst this seems to me decisive of the matter, I will nevertheless examine the provision of the act which is put forward as a ground for implying that Congress intended to confer upon the Federal Reserve Board the power in question That provision, which is found in section 2 immediately following the grant of power to the Organization Committee to designate Federal Reserve cities and to establish Federal Reserve Districts, reads as follows

"The determination of said organization committee shall not be subject to review except by the Federal Reserve Board when organized *Provided*, That the districts shall be apportioned with due regard to the convenience and customary course of business and shall not necessarily be coterminous with any State or States The districts thus created may be readjusted and new districts may from time to time be created by the Federal Reserve Board, not to exceed twelve in all "

The merely negative statement that the determination of the Organization Committee "*shall not* be subject to review except by the Federal Reserve Board when organized" clearly can not be enlarged into an affirmative grant of power to the Board to review and set aside everything done by the Organization Committee The reasonable view is that by that language Congress meant that the determination of the Organization Committee should not be subject to review at all, except

in so far as the subsequent provisions specifically authorize a review by the Federal Reserve Board. The only subsequent provision authorizing a review of the determination of the Organization Committee of the Federal Reserve Board is contained in the sentence—

“The districts thus created may be readjusted and new districts may from time to time be created by the Federal Reserve Board, not to exceed twelve in all”

But the power to *readjust* districts does not necessarily carry with it the power to *abolish* districts and banks. On the contrary, it would be departing from the usual meaning of the language to give it that effect. In the affairs of business especially the word “readjust” is associated with the idea of preservation rather than of destruction. When it is used in connection with any business or political entity we instinctively think not of the destruction of that entity but of its preservation in some other form. When it is used in connection with a geographical area, such as a district, we instinctively think of changes in boundary lines, not of the blotting out of anything. To illustrate, suppose the Constitution had provided that Congress should have power to *readjust* the States taken into the Union. Would it be contended that this included power to abolish States? I can not think so. Likewise here, in my opinion, the power to readjust districts refers to changes in boundary lines.

This conception of the power is exemplified in the changes heretofore made by the Federal Reserve Board in the boundaries of the districts as fixed by the Organization Committee. To cite one instance, northern New Jersey was detached from the district of which Philadelphia is the center and annexed to the district of which New York is the center.

But if what was meant by readjustment of districts were obscure instead of reasonably clear, there would still be no ground for implying the power to abolish districts and consequently to abolish banks from a power to readjust districts and to add new districts.

A power not expressly conferred can arise as an incident to the exercise of some other power only because essential to the exercise of that power or because included therein as a *lesser* power of like nature or effect. (The *Floyd Acceptance*, 7 Wall, 666, 680, Branch *v* Jessup, 106 U S, 468, 478.)

No one would say that the power to *abolish* is a lesser power than the power to readjust. It only remains then to inquire whether the power to *abolish districts and banks* is essential to the exercise of the power to *readjust districts*. In other words, would the power to *read-*

just districts, which is expressly conferred upon the Board, be nullified or rendered impotent if the power to *abolish districts and banks* is withheld?

I have not heard that contention made and do not see how it could be made. Obviously the power conferred can fall short of the power of abolition and still have a wide and useful field of operations. From time to time much may be done to promote the convenience and efficiency of the system by readjusting the boundaries of districts, adding here and taking away there, without abolishing districts and without abolishing banks.

The only grounds upon which a power may be implied are thus lacking here. Rather the specification of the power to readjust districts and of the power to increase the number of districts carries with it the implication that Congress did not intend to grant the greater power to abolish districts. As the Supreme Court has said in similar circumstances

"If Congress had desired to grant such authority it would have been easy to have said so in express terms." (*Tillson v United States*, 100 U S, 43, 46)

Again it does not seem reasonable to suppose that Congress would have authorized the Organization Committee to establish these very elaborate banking units if another body to be organized only a few months later was to have the power not only to make readjustments among them but to abolish altogether a substantial number of them.

Finally, the power of readjusting districts and of creating new districts conferred by this provision upon the Federal Reserve Board is subject to two limitations only. (1) There must be "due regard to the convenience and customary course of business," and (2) the number of districts can not exceed 12 (sec 2). If, therefore, the power to readjust districts includes the power to abolish districts, I see nothing to prevent the Board from abolishing districts and banks until the number is reduced not only to eight but to six, four, or even one, if in the judgment of the Board "due regard to the convenience and customary course of business" dictates that policy. Assuredly Congress intended no such result.

But not only does *this* provision afford no sufficient basis for implying that Congress intended to grant the power in question, there is *another* provision in the Act which shows affirmatively, I think, that it *did not* intend to grant that power.

Section 4 provides that—

"Upon the filing of such certificate with the Comptroller of the

Currency as aforesaid, the said Federal Reserve Bank shall become a body corporate and as such, and in the name designated in such organization certificate, shall have power

"Second To have succession for a period of twenty years from its organization unless it is sooner dissolved by an act of Congress, or unless its franchise becomes forfeited by some violation of the law"

Here is an assurance by Congress that a Federal Reserve Bank organized under the provisions of this Act shall have the right to exist for a period of 20 years, except in two specific contingencies, i e, unless it shall forfeit the right by a violation of law, or unless Congress itself shall shorten the period

The Federal Reserve Banks were organized, their capital subscribed, and large obligations undertaken by them on the faith of that express assurance and in the expectation of enjoying that right

Manifestly, to imply a power in the Federal Reserve Board to abolish Federal Reserve Banks at will would directly conflict with the rights and powers expressly conferred upon those banks by this section

A power thus *expressly* conferred can not be destroyed or seriously impaired by *implying* a conflicting power—at least not unless the grounds for the implication are irresistible, which, as we have seen, is not the case here (Texas & Pacific Ry Co v Abilene Cotton Oil Co, 204 U S, 426, 440, 441, 446, Wilder Mfg Co v Corn Products Co, 236 U S, 165, 174, 175)

Finally, it remains to be observed that the reports of the committees which considered this Act and the debates attending its passage, while discussing fully many different powers conferred or proposed to be conferred upon the Federal Reserve Board, contain no mention of the power here in question This is very significant It shows, I think, an entire absence on the part of Congress of any thought of conferring such a power For, considering the far-reaching consequence of the power, it is not easy to believe that if the granting of it had been under consideration at all, the fact would not have been mentioned by some one in the course of the thorough and exhaustive discussion which the subject underwent in Congress

I sum up my conclusions as follows

First, concededly the power to abolish Federal Reserve Districts and Federal Reserve Banks is not conferred upon the Federal Reserve Board in express terms, second, it is a rule of statutory construction that the failure to grant in express terms a power of such great conse-

quence raises a convincing presumption that Congress did not intend to grant it, third, putting out of view that presumption, there is no provision in the Act from which an intention to confer this power can fairly be implied, but on the contrary there is a provision which shows affirmatively that Congress did not intend to confer it, fourth, the absence of any mention of such a power in the reports of committees and the debates dealing with the legislation shows that the thought of conferring it was not in the mind of Congress. I am of the opinion, therefore, that the Board does not possess the power in question.

Very respectfully,
T W GREGORY,
Attorney General

The PRESIDENT,
The White House

APPENDIX C TO CHAPTER XXXIV

LETTER FROM REPRESENTATIVE GLASS TO F A DELANO, MEMBER OF THE FEDERAL RESERVE BOARD, ON THE MOVEMENT WITHIN THE BOARD TO REDUCE NUMBER OF RESERVE BANKS

November 13, 1915

Strictly confidential

My dear Mr Delano

On reaching my hotel tonight I find your confidential note, with enclosure of report of your committee, for which I thank you. I had read in the *Washington Star* of yesterday a paragraph to the effect that the Federal Reserve Board contemplated some such action as that proposed by your committee, but, being somewhat incredulous, I called Dr Willis over the 'phone last night to ascertain, if I properly might, whether the publication had a real basis in fact. Being assured that it had, I today prepared a statement for the newspapers in which I challenge the right of the Board to do what is suggested and comment on the reason assigned by the *Star* for the meditated proceeding. However, aside from my utter distaste for newspaper disputation, I am otherwise dissuaded from public discussion of the matter just at this moment.

You have been so consistently courteous and cordial to me, my dear Mr Delano, and so considerate also, that it pains me to have to disagree radically with any view that you express concerning the administration of the Federal reserve system. Yet, the very fact that

I have felt so strongly drawn to you and have been so confidently impressed by your earnest devotion to the work of the Reserve Board, prompts me to write very plainly with respect to the committee report which you have done me the kindness to transmit

I was among the few members of the House Banking and Currency Committee who hoped that the Reserve Board Organization Committee would start the system with the minimum number of regional banks I was among the *very* few members of either branch of Congress who felt that there was much exaggeration of the real peril in Mr Warburg's "piping" system which received such scant consideration, so what I say now may not be related to any preconceived prejudice against a reasonable concentration of reserves or liking for a large number of reserve banks I simply question outright the power of the Federal Reserve Board to reduce the number of banks and, apart from every other consideration, I think such action would be a usurpation of authority for which no defense can be found in the text of the act itself and I know it would be a perversion of the intent of those who drafted the bill and managed the legislation

The currency bill, as originally drawn contained no reference to the question of abolishing reserve banks beyond that involved in the paragraph relating to the charter-life of a bank, which could be terminated only by act of Congress or by forfeiture for violation of law This was held by most of us to be sufficient But there were members of the Committee so bitterly opposed to the centralization of reserves and so fearful of control by a few banks, in subjection to "special interests," that an amendment was made which provided that *"no federal reserve district shall be abolished nor the location of a federal reserve bank changed except upon the application of three-fourths of the member banks of such district"* In vain some of us pointed out that this was in conflict with the "charter-life" provision of the bill those fearful of a system of few banks prevailed in the House Committee But the Senate Committee, noting the conflict, eliminated the amendment cited, and the House conferees on disagreeing votes, of which I Was one of two, concurred in the alteration, for the reason indicated Thus we gave the Federal Reserve Board authority to "create new districts," distinctly modifying the term by immediately and clearly indicating that the modus was to be by multiplication, "not to exceed twelve in all" To "create" doesn't mean to "destroy" We distinctly did not give, even by implication, nor intend to give, the Board power to reduce the number of banks first created There is not, in my belief, a vestige of sanction in the

act for any different assumption. Certainly there is no warrant of authority to "abolish" districts in the power conferred on the Board to "readjust" district lines. Readjustment of lines cannot mean extinction of districts, nor can the power to "review," upon appeal, the work of the Organization Committee in locating reserve banks be reasonably interpreted into authority to "abolish" banks. No such interpretation of the phrase, standing alone, would be tenable. read in connection with section 4, expressly reserving to Congress alone the right to dissolve banks, such interpretation, as it seems to me, is impossible. But this strained construction of the phrase, if ever admissible, could not be applied now without coming in plain and sharp conflict with the charter-life provision of the act or without involving the federal reserve system in disastrous litigation. Such action to be regarded, in any sense, a "review" of the work of the Organization Committee as to chartering banks, should have been taken (1) before the Secretary of the Treasury, as required by the act itself, *"officially announced the establishment of a Federal Reserve Bank"* in a specified district and (2) before the bank proposed to be abolished had been, as provided by the law, *"authorized by the Comptroller of the Currency to commence business under the provisions of this act"*.

But, as I have said, it was never intended that these terms should bear any such construction as that which I fear your Committee placed on them, albeit you do not explicitly say upon what sanction of law the Federal Reserve Board would rely for the extraordinary action proposed. I am not a lawyer nor an adept in the interpretation of law, but I do know what the proponents of the federal reserve act and the managers of the legislation intended to write on the statute book.

Moreover, assuming that you have the power, I find myself unable to agree with your Committee's argument for the proposed action, and I totally dissent from the printed reason ascribed to the Board for its contemplated abolition of certain reserve banks. Congress did not act carelessly nor in ignorance in fixing the maximum number of reserve banks. I am writing hastily at my hotel, where documents are not available, but in the archives of my committee-room is abundant evidence of the painstaking care with which expert compilation were applied to this question, and not one of the existing reserve banks falls one dollar under the computation of probable resources made by our actuaries, so there has been no decentralization of reserves beyond that which Congress deliberately sanctioned. Of course I do not know with what evidence your Committee can fortify its suggestion

that Congress did wrong in authorizing, and the Organization Committee in establishing, twelve reserve banks, but I cannot imagine that it relates to lack of resources, because the chief officer of one of the reserve banks proposed to be abolished has recommended to the Board that it shall include in its suggestions to Congress an amendment to the federal reserve act authorizing a return to member banks of 95 per cent of the normally available capital subscribed, thus radically reducing the capital resources of the banks. Furthermore, it is in the power of the Board to make the resources of strong banks available to aid weaker banks in time of stress. It is a complete, not a fragmentary system.

I cannot think, either, that your evidence relates to the reason given in the *Washington Star* for the abolition of certain banks, to the effect that "four of the banks lost money for the quarter ending September 30." You know and I know that some of the administrators of federal reserve banks have not tried to earn expenses. Quite the contrary, they have tried not to earn expenses, to my knowledge they have intrigued to this end. And this to me is not astonishing, for a member of the Board and your Committee, our mutual friend Mr. Warburg, has publicly proclaimed that he would have been "ashamed of these banks" had they earned their expenses. While I do not agree with Mr. Warburg as to the economics of this view, I am cheerfully willing to concede that there was nothing sinister in his declaration, but there are those who will misunderstand his remark and ascribe it to a desire to wreck the federal reserve system and build upon its ruins his eagerly desired bank of banks. And if the Federal Reserve Board, either through usurpation of power or exercise of authority which the federal reserve act may be thought to confer, should at this time try to abolish certain reserve banks because all the banks have not earned expenses, Mr. Warburg's avowed wish that they shall not be self-sustaining will be plausibly imputed to him and to the Board as undisguised hostility to a system and part of a scheme to discredit it. And, unhappily, this belief would be accentuated by the incontestable fact that the Board itself, under the persistent leadership of Mr. Warburg, has failed to put into operation mandatory provisions of the federal reserve act which were intended to enable the federal reserve banks to earn expenses and which no member of the Board, I must assume, will deny would enable these banks to earn expenses. It is my deliberate judgment that the action proposed by your Committee, if taken at this time, would arouse a spirit of ferment and of

bitter resentment in the country, especially in the large sections affected, which would speedily be reflected in action by Congress

I have frankly admonished Mr Warburg in the kindest spirit of sincere friendship that his conception of the federal reserve system as a purely "emergency" institution is wholly foreign to the view of the administration which recommended and the Congress that brought that system into being. It was never intended by anybody who had any effective part in the inception and passage of this legislative act that these banks should be practically moribund for nine out of every ten years of their existence and only be put into action to "save a situation" or to retrieve financial disaster

If we want a system of that kind, we can return to the hybrid Vreeland-Aldrich scheme, which would enable us to abolish the Federal Reserve Board, as well as the federal reserve banks, and conduct the enterprise from a corner bureau in the Treasury building. I have supposed that in the federal reserve act we had instituted a great and vital banking system, not merely to correct and cure periodical financial debauches, not simply indeed, to aid the banking community alone, but to give vision and scope and security to commerce and amplify the opportunities, as well as to increase the capabilities of our industrial life at home and among foreign nations. I am not willing yet to think that I have misconceived the thing

I have written ten times more than I purposed to say, Mr Delano, when I started to acknowledge the courtesy of your note, and, what is more, have written with my own hand, which is distinctly against my physician's advice. But I cannot conclude without taking the very great liberty to suggest that you should long and carefully consider the astounding intimation of your Committee that the federal reserve system, which at the very weakest period of its existence—in its infancy, so to speak—has withstood the shock and upheaval of the greatest war in the history of the earth, will, in its growth and strength, be gravely endangered when the readjustments of peace ensue. To me this is startling. I believe such a forecast of deficiency seriously made public by the Federal Reserve Board would alarm the country to the point of panic, and do it instantly. I believe it would put a check to enterprise and a rein upon endeavor that would result in immediate doubt and ultimate disaster. I do not at all participate in your fears. I think we have a good banking system, which will continue to prove itself in larger measure as those who administer it give it a fair chance and operate it with confidence. I know you want to do this, and I could wish for you no greater distinction, nor for

our country any greater blessing, than would be involved in the actual achievement

I hope to be able to have this letter typewritten before I leave for New York Monday morning and to subscribe myself, with cordial regards

Faithfully yours,

CARTER GLASS.

Hon F A Delano,
Federal Reserve Board,
Washington, D C.

CHAPTER XXXV

THE GOLD SETTLEMENT FUND

Two Kinds of Clearing

As has been seen at another point, the Federal Reserve Act had made provision for two kinds of clearing operations, the one local or district, the other interdistrict or national. Of the two, the national system of clearing was by far the easier to install. This was for the reason that it was exclusively an intrasystem mechanism whose functions were directly concerned with the facilitation of system transactions, so that it did not interfere with the operations or profits of other banks. True, as the federal reserve system itself developed, it might be expected that this inter-reserve bank system would prove of fundamental importance in bringing about the success of the local or district clearing system which had been encouraged at federal reserve banks under direction of the board, but this was too remote a prospect to afford good ground for very determined opposition to the undertaking. Moreover, it became very early apparent that if the federal reserve system itself was in fact to be a *system*, it must have some means of communication between its different elements. Inter-reserve bank transactions were distinctly contemplated by the Federal Reserve Act, and it needed only a superficial study to see that unless the reserve banks were to resort to the somewhat ridiculous expedient of communicating through other banks, some practical means of intrasystem operations would have to be devised.

Object of Reserve Act

In framing the Federal Reserve Act it had not been deemed expedient to make an elaborate or detailed provision for the establishment of this intrasystem clearing, but it had been felt that enough would be done by bestowing broad powers and leaving them subsequently to be interpreted and applied. Consequently, in the Federal Reserve Act as adopted there was found in Section 13 the grant of authority to the Federal Reserve Board to act as a clearing house for the several reserve banks or to designate some reserve bank so to act. The latter part of the provision had been retained as a kind of survival from an earlier plan which had been in contemplation during the early days of organization of the system. This plan had contemplated the establishment of one reserve bank or of a joint branch of all reserve banks at Washington, in order that the Board might have the actual banking machinery under its immediate control. With the abandonment of this idea and with the decision to rely only upon the ordinary machinery of the reserve banks themselves and not necessarily to bring any one of them into close connection with the Board, the latter part of the provision became obsolete in effect, so that the only phase of it which remained practical was that which authorized the Board to act as a clearing house for the several federal reserve banks.

Meaning of Clearing House

Much now depended upon the meaning of the term "*clearing house*" as thus employed. The subject, as already seen, had been elaborately discussed by the Preliminary Organization Committee which, after much debate, had accepted a plan for the creation of a gold settlement fund at Washington. Working upon the theory that in this connection at least a relatively narrow interpretation must be given to the term "clearing house," since the other or broader functions exercised by clearing houses in general were practically all covered under

the Board's general banking authority. In the view of the Preliminary Organization Committee, therefore, the power bestowed upon the Board, as already described, was in essence a power to provide machinery for the actual process of clearing in the technical sense of the term. So strongly had the Preliminary Organization Committee been impressed with this view that its recommendations with reference to the application of the power had related practically alone to the installation of the clearing process. It is worth while to note at this point the recommendations which had been made by the Preliminary Organization Committee and which were therefore before the Board at the time when the system was passing through its first period of organization. The preliminary committee in its report had furnished the following outline of procedure which it strongly recommended

Proposed Plan

To settle the balances between reserve banks, growing out of these various transactions, a clearing house is suggested, as provided in the act, in the clause which specifies that "The Federal Reserve Board may at its discretion exercise the functions of a clearing house for such Federal reserve banks, or may designate a Federal reserve bank to exercise such functions."

If one of the Federal reserve banks should be chosen as a clearing house, for convenience of location it might be the Chicago bank, but this function of clearing would be better assumed by the Federal Reserve Board. For many reasons it would be well to establish the clearing house at the national capital. Since each reserve bank will carry a single account with every other reserve bank, subject to simultaneous debit and credit, the bulk of the interchange of business will clear itself. Balances will arise partly on account of the seasonal changes which will alter the debit and credit relationship between the districts, and partly on account of the fact that membership in the system will not be proportionately equal as between national and State banks in different regions.

The plan herewith proposed is based upon the requirement that each Federal reserve bank deposit with the Federal Reserve Board clearing house all of its gold beyond that which will be sufficient to take care

of local needs This gold deposit, carried on the books of each reserve bank in a separate item as a part of its reserve funds, can be used in either of two ways or in a combination of them to effect settlement which will be explained later Settlement need not be made between reserve banks oftener than weekly, since to require daily settlement might prevent the operation of the natural clearing effected by the interchange of ordinary business transactions Therefore, at the close of business on each Thursday, each reserve bank should wire the clearing house the amount of the balance and should state whether debit or credit relations exist between it and other reserve banks Allowing one day, Friday, for adjustment of any differences in the advices received, the clearing would be effected on Saturday How this shall be done depends upon a consideration of the following possibilities.

The gold deposited with the clearing house may be credited upon a simple set of books to each bank so depositing Clearing would then be effected by a charge and credit on the books, and advice would be made to the reserve banks This is the simple plan, but it has one apparent disadvantage in that the banks would have no tangible evidence of the ownership of the gold other than a book credit Consideration might, therefore, be given a plan of issuing certificates in large denominations against the proposed gold deposits as clearing house currency certificates are now issued Upon the direction of the Federal Clearing House, the debtor reserve banks would mail these certificates to the creditor banks to pay balances These two plans might be combined so that, although the clearing of balances would be effected by book transfers of gold at the Federal Clearing House the debtor banks could anticipate this settlement by mailing certificates to creditor banks prior to the day of settlement. Both these plans, however, seem less effective and more cumbersome than the first plan Very little (if any) gold would ever need to be transferred between the reserve banks, and such operations would be limited to transactions between the banks and the clearing house The banks, in turn, would be able to loan or borrow, buy or sell gold in dealing with each other, and the transactions would be arranged through book transfers at Washington

It is recommended that the official who may act for the Federal Reserve Board as supervisor of the clearing functions of the system act also as the manager of the Federal Reserve Clearing House, and bear the same relation to the reserve banks that the manager of any clearing house does to the members of a city clearing house In addition to the supervision and control over the entire machinery of

domestic exchange, he should provide for its development along lines hereafter suggested

Choice of Methods

All that was necessary in this view of the functions of the Board was, first of all, to make a choice between the idea of designating a federal reserve bank to act as a clearing house, and that of installing some mechanism in the actual offices of the Board. The whole question of interbank relationships had, as was seen in connection with district clearing, proved a stumbling block from the very initiation of the Board's operations. This, it was true, had related to the district clearing, but the fact that the Board also regarded the national clearance as likely to give ground for trouble was seen in the circumstance that it did not at once provide for the adoption of the comparatively simple machinery which the Preliminary Organization Committee had recommended. The question of taking some action, however, came up early in the year 1915, and as weeks passed and the organization of the several banks proceeded so that they grew into real working concerns, the need of something of the kind became more and more evident. The Board, however, deemed it expedient to refer the matter to the then conference of governors which took it under advisement. The attitude of the conference of governors on the subject was unsatisfactory and in a veiled way was hostile to the whole proposal. If it was to be adopted, they believed, it should be done through the designation of a federal reserve bank to do the work. The Federal Reserve Bank of Chicago presented itself as a candidate for such designation, and the first contest over the new national system of clearance turned around the question of this designation. This, however, was settled after only a brief debate, by a determination on the part of the Board to take over the clearance function itself. That decision having been made known to the governors of the banks, partly through letter and partly as a result of conferences conducted

at Washington and elsewhere with the aid of transit experts, the actual determination what to do practically passed out of their hands, the only field of effort remaining to them being that of determining details of technique of operation at the several banks. This proved the basis of more or less debate among themselves and eventually resulted in a recommendation to the Board with reference to the details of the undertaking.

Absence of Governors' Recommendations

The recommendation, however, contained nothing of a practical nature applicable to the conduct of the Board's own management of the clearing fund, save the suggestion that this fund be limited to \$1,000,000 gold deposit to be made by each of the reserve banks as an initial fund. The governors had been troubled about the question whether the money in the gold settlement fund could be counted as reserves or whether it would constitute a deduction from their actual gold stock. This matter was referred to the Board's counsel who rendered a decision to the effect that the gold actually in the settlement fund could undoubtedly be regarded as constituting a part of the reserve funds of each federal reserve bank, and accordingly the principal basis of opposition to the establishment of a substantial clearance fund was eliminated. The governors, however, succeeded in holding down the initial deposit to \$1,000,000 for each bank. Inasmuch as nothing had come from the governors with reference to the technique of the office management of the fund at Washington, it was decided by the Board to place in the hands of the Board's Secretary the question of arranging the installation. The Secretary of the Board accordingly obtained the assistance of Mr. O. H. Wolfe, who had been a member of the Preliminary Organization Committee, and the outlines of a set of clearing books for the use of the gold settlement fund were provided by Mr. Wolfe and eventually approved by the Board. The gold settlement plan itself as thus provided for became the subject

of a regulation by the Board which was issued to the public about May 8, 1915 This constituted the definite foundation upon which the clearing operation was ordered to become operative on July 1, 1915 The order was as follows

The Board herewith encloses a regulation concerning the operation of the gold settlement fund, and also instructions containing a list of dates on which the various steps are to be taken leading up to the establishment and the beginning of the operations of this fund

The question of transfers between federal reserve banks has been fully discussed with a committee of governors on "clearings" and the report of that committee, dated May 6, 1915, is hereto appended The Board is in accord with the principles and recommendations contained in this report and suggests that each bank proceed promptly to prepare the necessary schedules and whatever instructions may be thought appropriate for its own member banks

Forms to be used for the transfers are in course of preparation by the above-named committee and will be transmitted to you in due course

Inclosed, herewith, is a revised time schedule regulating the time allowance to be applied in crediting or debiting accounts in connection with transfers between member banks

The documents referred to in the letter follow —

Instructions to Federal Reserve Banks relative to the establishment of the gold settlement fund

(1) At the close of business Wednesday, May 19, 1915, each Federal Reserve Bank will telegraph to the Federal Reserve Board the amounts in even thousands due to each other Federal Reserve Bank as of that date

(2) Thursday, May 20, settling agent will telegraph to each bank the amounts of credits to its settlement account, giving the name of each bank from which such credits were received, also net debit or credit balance in settlement A confirmation will be sent by mail

(3) Each bank will be expected to forward to the nearest sub-treasury not later than Monday, May 24, 1915, in gold, gold certificates, or gold order certificates properly indorsed, at least \$1,000,000, and in addition an amount equal to its net debit balance as telegraphed by the settling agent Transfers of gold or gold certificates should be credited to the account of "Gold bullion and U S coin" and "U S gold certificates," and charged to the item, "Gold settlement fund" on the books of the Federal Reserve Banks.

(4) As soon as all transfers have been effected each Federal Reserve Bank will be advised by telegraph, at which time the transfer entries should be made on the books of the bank. Each Federal Reserve Bank will then debit the *due to* Federal Reserve Banks' accounts and credit the settlement fund, and will credit the *due from* Federal Reserve Banks' accounts and charge the settlement fund.

(5) The second settlement will be made on May 27 and figures telegraphed as at close of business on May 26, and at weekly intervals thereafter.

Actual Installation

The actual announcement that the installation of the national clearing system had been determined upon aroused more or less ineffective criticism and complaint on the part of clearing house and banking experts throughout the country, who had paid comparatively little attention to the plans while they were in progress. Meetings which were then in progress in Washington brought together a considerable number of financial and banking experts, and, although these sessions had nothing to do with the federal reserve system, they formed the occasion of more or less discussion of federal reserve matters. Among these the new clearance system assumed a prominent place, and it was the expressed opinion of various bankers who were then present that the plan would be found unworkable within a period of not to exceed sixty days. This view was freely expressed and appeared to be the prevailing idea in clearing house circles, although no formal protest or show of opposition was made to the plan. The prediction that it must necessarily fail seemed to be founded upon the thought that the flow of funds from one part of the country to another was so highly seasonal that the gold deposit of \$1,000,000 for each bank would not suffice to effect the settlement—that is to say, that any of the banks might easily become far more deeply indebted to one or more of the others than would be possible to adjust through transfers based upon the comparatively small fund in the hands of the Board. A few critics

who went further than this took the view that certain parts of the country were continuously and permanently indebted to other parts—that is to say, that there was a steady flow of current funds from some parts of the country to financial centers. Inasmuch as these financial centers, it was supposed, did not coincide with the locations of federal reserve banks or with that of the Board, it was assumed that the currents of clearance would not move in such a way as to offset one another, so that it would speedily appear that the Board's settlement fund would be swallowed up in the process of adjustment.

Defect in Criticisms

There was an element of truth in these criticisms, but they fundamentally ignored the fact that whatever might be the permanent indebtedness of one part of the country to another, the current indebtedness necessarily settled itself currently, and that unless it was to be assumed that movements of money resulted in piling up or accumulating quantities of cash at certain points, there must necessarily be a credit settlement on the books of the banks, so that as a result a natural process of clearing would take care of the bulk of the payments if given an opportunity to do so. On the other hand, it was ignored by critics that even if the fund in the hands of the Board should prove insufficient, there was nothing to prevent settlement by the process of rediscounting between federal reserve banks or by that of increasing the balances in the gold settlement fund. Both these methods of settling came within a very few months to be largely employed, and after the United States became a belligerent in the European war, with the result that fiscal transactions between banks grew very heavy, the theory upon which the settlement fund was based was amply and repeatedly vindicated. At the time of its initiation the weight of current banking opinion was unmistakably against it, and even some of those who had devoted special attention to the study of clearance and credit took the view

that it would be either a failure, or, if a success, would prove to be so because of the fact that but little strain was brought to bear upon it—that the operations of federal reserve banks were so inconspicuous and unimportant as to cause but little draft upon the mechanism of the clearance system

One of the points at which the efforts of sundry governors has succeeding in restricting the operation of the gold settlement fund, was found in a limitation of the clearance to once a week. Recommendations made by the conference had been based upon the view that transactions at reserve banks would always be so small that daily clearance would be unnecessary, while it had also been thought that the daily clearance would in some unexplained way interfere with the offsetting of items on the books of the several reserve banks. Consequently, the new system had been placed on a weekly basis from the outset, while it had been agreed to clear only one side of the indebtedness at reserve banks—the item “Due to” being selected as the basis of settlement. With these restrictions the new plan went into operation on July 1, 1915. On Wednesday evening of each week, each federal reserve bank telegraphed the Board at Washington the amount of the items due to other federal reserve banks appearing on its books. This item was telegraphed in round numbers only (multiples of \$10,000) and after the twelve telegrams had been assembled in the office of the Board on Thursday morning, the net amount payable by any federal reserve bank was ascertained through a process of combining its claims against others with their claims against it. Ownership in the gold fund under the Board’s control was altered accordingly, and statements were thereupon returned to each federal reserve bank showing the net change in its ownership of gold in Washington and the process by which this net change had been effected. Thus, for example, if the Federal Reserve Bank of Atlanta was found indebted to six federal reserve banks, while at the same time a creditor of five others, the two sides, however, happening to be just sufficient

to offset each other, the Federal Reserve Bank of Atlanta would be informed that there had been no change in its net ownership of gold but that in the process of clearing it had settled with the other eleven banks in amounts which were set forth in the statement

Working of Fund

The working of the fund in these respects was more clearly set forth by the Board about a month after the system had been fully installed, as follows

Deposits in the gold-settlement fund have now reached the sum of \$30,540,000. This is held in gold certificates issued by the Treasurer of the United States in denominations of \$10,000, payable to the Federal Reserve Board and perforated with the words "Payable only to the Treasurer of the United States or a Federal reserve bank." These certificates are kept in a safe with two combinations, which safe is placed in one of the larger vaults of the Treasury Department, access to which can only be had by two officers of the Board acting together.

In this issue of the Bulletin is given a summary of the transactions through the fund from May 19 to June 24, inclusive. A total of \$18,450,000 had been deposited up to the time of the second settlement, made on the morning of May 27. As a result of this settlement the balances of several Federal reserve banks fell below the required amount of \$1,000,000 each, and additional gold deposits were made to the amount of \$4,400,000, increasing the gold in the fund to \$22,850,000. After the settlements of June 10 and 17 additional gold deposits were required, and the amount of gold held in the fund has thus been increased to \$30,540,000, at which figure it stood at close of business June 24.

On Wednesday evening each Federal reserve bank telegraphs to the Federal Reserve Board the amount due from it to each other Federal reserve bank. These telegrams are all in the hands of the Board early Thursday morning, and the figures given are then assembled on a sheet known as "the checkerboard," which has the names of the Federal reserve banks at the head of 12 columns and also at the left-hand margin. From the telegram of each bank the amounts which it reports due to other Federal reserve banks are listed in the proper columns under the names of the other banks, the total being entered at the right margin, and each horizontal column thus shows amounts

and total which the Federal reserve bank owes to all the other reserve banks. When the figures from the 12 telegrams have been entered the vertical columns show the amounts and total due from other Federal reserve banks to the reserve bank named at the head of each column. Each bank is then charged with the amount due to other Federal reserve banks and credited with the amounts due to it from them, the net amount to its debit or credit being carried to its account on the books of the gold-settlement fund. A telegram is sent to each bank giving the amounts which other Federal reserve banks report due it, and the net amount by which it is debtor or creditor at the clearing. Upon receipt of this telegram it charges the accounts of other Federal reserve banks for the amounts it has reported due to them, and credits their accounts with the amounts which they have reported due to it, the obligations in each case having been extinguished by the operation of settling and the transfer of title to gold held in the gold-settlement fund.

In response to a request from a Federal reserve bank, the Federal Reserve Board has agreed to pay to the Treasurer of the United States from the gold-settlement fund sums in multiples of \$10,000 for the credit of any reserve bank's gold redemption fund with the Treasurer of the United States.

This information has been transmitted to the other 11 banks. No request from a Federal reserve bank for the transfer of funds other than the weekly settlement had before been received.

Successful Operation

Contrary to what had been expected by some, the working of the gold settlement fund was a success from the beginning and practically none of the difficulties that had been predicted made themselves apparent. The system was recognized from a date soon after its inception as of the utmost utility in bringing about a balancing of the accounts of the reserve banks, and even those governors who had been lukewarm or hostile in the beginning soon changed their minds. There was nothing in the gold settlement fund which could have been regarded as in any way interfering with member bank operations, since nothing in the way of a national clearing house system had ever been developed. Lacking such a national

clearing system, the idea of competition with any existing institution was of course impossible and there was no reason to fear loss of profit. On the contrary, since the public had no direct access to the use of the gold settlement fund, it afforded a certain possibility of profit to banks which were engaged in making sales of domestic exchange. Critics who had, as already seen, foreshadowed the breakdown of the system due to exhaustion of the gold contained in it, had only this element of support for their views—that the transactions through the fund speedily became so large that it was necessary to draw upon the various banks for a material addition of the gold deposit which they carried with the fund. Had this not been done weekly, indebtedness would often have been sufficient to wipe out the balance, creating a large deficit against a given bank. This merely meant that the scale on which the fund had been opened was far from being sufficiently adequate and that to swing the business relationship between different parts of the country a very much larger permanent stock of gold in the fund was required. Additions to the gold fund were thus early necessitated, and as time went on, the motives of convenience and ease of protecting the specie supply led reserve banks, which otherwise would not have carried more than a moderate balance in the fund, to turn over to it a large share of their working specie. In little more than a year after its inception, the gold fund was a pronounced success. It was well that such proved to be the case, for without it the immense transactions of the war could not have been conducted save at the hazard of great disturbance to the business and financial structure of the country, and to the maintenance of stable relations between different sections of it. So efficient did the fund itself become after the opening of the war, that the frequency of clearance was by the middle of 1918 advanced to the daily basis. Of the service thus rendered by the gold fund, however, more will be said at a later point.

This chapter has dealt only with matters relating to its organization

APPENDIX TO CHAPTER XXXV

The governors, however, added to the par clearance system a plan for collection which, like the earlier clearance plan, gradually became obsolete. The original collection plan was as follows

REPORT OF THE COMMITTEE OF GOVERNORS ON COLLECTION METHODS

Washington, D C, May 6, 1915

To the Federal Reserve Board

The committee of governors, appointed to consider collection matters, believes that, in the interest of sound banking practice, transfers of funds by member banks through the Federal Reserve Banks should be encouraged, and that it will both induce and facilitate such transfers if standard forms be prepared by all the Federal Reserve Banks and distributed among their members for general use. They recommend that such forms be prepared, and, if desired, suggestions for these forms will be submitted by the committee.

The committee on clearing further recommends that no stated charge be fixed for interdistrict mail transfers to be made by Federal Reserve Banks for their members, but that, inasmuch as conditions vary greatly in the several districts, and will fluctuate with the seasons, each Federal Reserve Bank be allowed to arrange its own schedule of charges to be based upon the cost of the service rendered, and adequate to protect it in its dealings with its members. The cost of such transfers should not exceed the expense of shipping currency to the nearest subtreasury city.

It further recommends that a protective charge is advisable upon all telegraphic transfers for members, and that such charge, when made, shall include cost of telegraphing and the interest on the sum transferred at a minimum rate of 2 per cent, for the time required by a Reserve Bank to make the transfer by mail in accordance with the schedule hereto annexed.

Whenever a charge for mail transfers is imposed, the protective charge for telegraphic transfer shall be in addition thereto.

(Signed) J B McDougall,
Chairman.

AVERAGE TIME (IN DAYS) TO DESTINATION BETWEEN FEDERAL
RESERVE BANKS

	Boston	New York	Philadelphia	Cleveland	Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
Boston		*1	*1	2	2	3	2	2	3	3	3	6
New York	*1		*1	2	1	2	2	2	2	2	3	6
Philadelphia	*1	*1		1	1	2	2	2	2	2	3	6
Cleveland	*2	*2	*1		2	2	*1	*2	2	2	3	5
Richmond	*2	*1	*1	2		2	2	2	2	2	3	6
Atlanta	*3	*2	*2	2	2		*2	*2	2	2	2	5
Chicago	*2	*2	*2	1	2	2		*1	1	1	2	4
St. Louis	*2	*2	*2	2	2	2	*1		2	1	2	4
Minneapolis	*3	*2	*2	2	2	2	*1	2		2	3	4
Kansas City	*3	*2	*2	2	2	2	*1	2	3		2	4
Dallas	*3	*3	*3	3	3	2	*2	*2	3	*2		4
San Francisco	6	*6	6	5	6	5	*4	*4	4	4	4	

* Indicates that items on the point at the top of the column may, at the option of the Federal Reserve Bank, be taken for immediate credit at par or at the market rate of exchange

CHAPTER XXXVI

THE POLITICIANS AND THE RESERVE SYSTEM

Relation to "Politics"

From the very first, the federal reserve system found itself obliged to confront certain political questions which had a broader character than any that depended merely upon appointments. In order to understand why this should have been true, it is necessary to go back to the peculiar position in which the Treasury had been placed as a result of the methods of distributing public deposits that grew up after the act of 1900. As has been shown at an earlier point, the Treasury had become practically a source of special favors to banks as represented by the long list of pet banks, while it had also come to be looked upon by the farming community as an ever-present help in time of trouble, to be approached without reserve whenever local banking institutions were either unable or unwilling to finance agricultural needs. Obviously, the federal reserve system should have ended all of this political favoritism and special aid. It had the machinery to meet all necessary requirements, and the smooth and steady working of that machinery should have done away with the possible demands that might come from special classes in the community whether through congressmen or through the Secretary of the Treasury, or otherwise. This, however, was not to be the case, and the early organization history of the system was so shaped as to set unfavorable precedents which have continued from that day to this to give trouble.

Bad Precedent in Aldrich-Vreeland Act

The Aldrich-Vreeland Law had set a bad precedent because of the large participation which it granted to the government in the making of currency advances against bonds and commercial paper. The act was so constructed as to make it seem that the "money-issuing power" of the government had only to be invoked in order to afford "relief" for a bad situation, or a condition in which overextension had occurred at the banks. This psychological aspect of the law was not to be ignored, for it tended to create a bad basis for the transfer of "emergency issues" from the Treasury to a purely banking organization. And yet, owing to the delay in establishing the federal reserve system, it had been necessary at the very beginning to extend the life of the Aldrich-Vreeland Law and to make it even more inclusive and effective than it had previously been. The working of the law itself furnished a bad example, because it created the impression among politicians that they had a reserve power which could be called into play to obviate the effects of bad banking on the part of the financial community, while it stimulated the producers all over the country in the thought that, instead of bringing the force of their opinion to bear upon bankers, they might as well direct the influence they thus exerted toward the government, treating it as the rectifier of all evils and the supplier of all shortages that might come to exist in consequence of defective management of business. Thus severe criticism must undoubtedly be directed toward, and strong regret expressed with regard to, the policy which had rendered it necessary constantly to employ a quasi-governmental means of assistance and which had thus established in a certain sense the practice of relying upon the Treasury for assistance.

Distribution of Deposits

Much more injurious, however, than "emergency relief" was the effect of the practice of regularly distributing deposits

which had grown up in former years. Politicians had become habituated to the practice of asking the Treasury Department to help out local communities by shifting to them the funds which had accumulated in other parts of the country, and to do this without cost or expense to borrowers in the hard-pressed regions. Administration after administration had accustomed itself to this paternalistic view of the Treasury Department, and had come to regard it as almost a governmental function to provide for crop-moving, or to strengthen the banks against danger of possible failure, or otherwise to relieve emergencies by merely shunting government deposits hither or thither as the case might be. The practice of still earlier years in paying the express charges upon money shipments in order to get silver dollars "out into circulation" helped in its way to establish a false attitude on the part of the community. All these questions the federal reserve system was obliged from the beginning to face, and it soon found itself compelled to answer the question whether it would be able to do all of these things and, still more important, whether it ought to do them. Should it answer in the negative, it would stand self-condemned in the eyes of the elements in Congress which had become accustomed to make demands of this sort on the Treasury and to have them satisfied.

An Early Test

The system, indeed, was not long in finding itself subjected to a strenuous test on this score. One of the unfortunate effects of the war on the United States was seen in the suspension of exports of cotton and the consequent depression of prices which ensued. This depression undoubtedly caused utmost hardship among cotton-growers and affected the whole of the southern producing region most unfavorably. There was every reason for extending any help that could be supplied, and in the absence of complete organization of the federal reserve banks, the Federal Reserve Board undertook to

render such aid as it could by the organization of the so-called cotton loan fund to which reference has been made at an earlier point. The depression in cotton in its more acute phases soon passed away, but not until southern politicians, dissatisfied with the prospective working of the cotton loan fund, had presented themselves at the offices of the Board with an urgent demand that it should take measures designed to maintain or advance the price of cotton. Just how this was to be done, there was no unanimity of opinion, and suggestions varied from the purchase of an enormous amount of cotton futures, to the making of direct loans to farmers on cotton in the field or in the warehouse. The Board at the time had not even the money to pay its own expenses, much less to engage in the purchase of cotton futures, even had it had any shadow of legal authority for so doing, which, of course, was far from being the case. But, in this first clash with the agricultural element in Congress, it became clear that the intention of that element was consciously directed to the obtaining of all forms of assistance or subsidy of a financial sort that had been habitually obtained under the old Treasury system. Public attention was at the time focused upon the war and the conditions growing out of it. This naturally prevented the sharpness of the controversy from becoming known to the nation at large, so that it failed to attract any attention at the time, but the elements of future trouble were plainly present.

Secretary McAdoo's Farm Policy

The Secretary of the Treasury, like the Board itself, had felt the pressure of these demands, and thought it politically necessary to satisfy them. He was saved from the necessity of doing anything of the sort during the autumn of 1914, because the cotton loan fund (although never used) served as a means of bridging over the political exigencies of the situation, while conditions themselves soon became so much better that there was never any real need for advances beyond what

banks, with the aid of the revised Aldrich-Vreeland law, were able to give. As the year 1915 advanced, however, all the old pressure began to renew itself, and in the summer of that year the Secretary of the Treasury began to insist upon special rates designed in aid of agriculture. The Board yielded to these demands but the details of what was then done relate rather to operation than to organization, and they must therefore be deferred. At this point it is intended only to set in as clear a light as possible the development of relations between the organization of the reserve system and the Treasury Department. It is enough, therefore, to say here that the Department was not satisfied with the measures taken by the Board for the relief of the farmer, and that the Secretary of the Treasury speedily announced his intention of making special deposits of public funds to be used in crop-moving.¹ At this time every federal reserve bank had a large body of unused funds and was rather morbidly anxious to get business enough to pay expenses and a minimum dividend. The banks were amply able to extend all loans that were needed for crop-moving or any other purpose. Had the Secretary of the Treasury made his deposits direct in member banks in the agricultural districts, he would to all intents and purposes have declared his belief that the federal reserve system was incapable of performing a particular kind of work for which it had been especially incorporated. To this extreme step he was not able to gain his own consent, but eventually compromised with himself by placing the funds of the government in the reserve banks in the districts which it was sought to relieve. This, of course, was a wholly futile and unnecessary step, since, as already stated, the reserve banks were already overburdened with funds that could not in existing circumstances be used. The agricultural deposit policy of the Treasury was thus little more than a fine gesture. It involved nothing, and resulted in

¹ The economic facts in the situation were fully explained to the Treasury in a memorandum prepared by Mr. Harding. (See Appendix to this chapter.)

no advances But the evil involved in it remained, for it recognized the whole political basis of deposit distribution and it also accepted the view that the farmer was in effect a pensioner upon the public bounty

Other Relations with Treasury

The problem of relationship with the politicians had thus at the start centered itself upon relations with the Treasury and the head of that organization In manifold ways, none of them as important as that relating to the distribution of public deposits, the question of political pressure upon the Board and the system soon became acute As has been seen at another point, the Board had resisted such pressure in connection with appointments, and, while it had yielded with respect to the deposits, it had done so as a result of sheer necessity and inability to help itself Early, however, in the process of organizing the system, a good many questions sprang up which were later to have a most significant bearing upon the management of the reserve organization Perhaps the most outstanding of these, next after the deposit problem, was that of relations with the Comptroller of the Currency

Reference has elsewhere been made to the fact that, while the Federal Reserve Act was in its later stages in Congress, it had been revised with a view to conserving as much independent power to the Comptroller of the Currency as possible, and that at the time it had been thought best to yield to these unwise changes in order to avoid incurring the opposition of Secretary McAdoo The bad effect of them, however, became apparent soon after the task of organization had been fairly undertaken Not only did the Comptroller of the Currency retain to himself full power of bank examination, as under the law he was undoubtedly entitled to do, but he absolutely declined to share with the Board or with the reserve banks the results of these bank examinations This was on the ground that the reports were confidential and could not be

divulged, a statement whose absurdity was apparent from a reading of the Federal Reserve Act, which had given to the Board and to the reserve banks exactly the same power to examine their members (who at the time were all national institutions) The absurdity of the situation was thrown into even higher relief by the fact, that within two years the Comptroller was himself to cede his former position almost entirely, it having in the meantime become untenable This, however, did not alter the fact that in the early months of its organization the Board was obliged to admit that a function which properly belonged to it and must necessarily be exercised with its full knowledge and co-operation if success was to be had, had been kept in the hands of a politically appointed official who was apparently largely out of sympathy with the working of the reserve system

This, moreover, was only the first of the difficulties encountered in the relationships with the Comptroller of the Currency He early took the view that all notes must be issued by and through him solely, and, owing to the system of oversight which he instituted, lengthy delays and postponements became the regular attendant of note issue The reserve banks complained and continued their complaints until the exigencies of war practically compelled a relaxation of the hampering regulations which had been thrown around the note issue function These complaints came promptly and forcibly to the Board, but found that body powerless to relieve the situation. Other methods of regular interference with the operations of the reserve organization were probably less important than either of those which have just been detailed at length, but the sum total of annoyances of this sort served as a considerable handicap to progress

Hostility of Treasury Organization

The fear and dislike shown toward the reserve system by higher officers soon spread all through the Treasury organi-

zation The Treasurer of the United States and his staff had, from the first, been fearful of the results of the provision whereby government deposits were to be transferred to reserve banks, since they naturally regarded that as foreshadowing the end of the sub-Treasury system with its many valuable sinecures From the start, therefore, more or less difficulty was constantly encountered in relations with the Treasurer, and his office, and these became more or less acute when the time came for the organization of the gold settlement fund, an operation which necessarily required some assistance from the facilities afforded by the Department itself The Treasurer of the United States has usually been an active politician, placed in office as the recognition of conspicuous position in or services to the party At the time of the organization of the Board, he was an outstanding figure in the politics of a western state, and before long became the mouthpiece of discontented agricultural interests who sought to impose their will upon the reserve system in order to secure a modification of its regulations relating to the discounting of certain types of agricultural paper This controversy eventually became public, and its effects were such as to add to the general friction and political pressure from which the early organization suffered

Presidential Relationship

No general view of the organization of the federal reserve system would be accurate unless it took account of the attitude adopted by the President toward the great system which had been built up under his leading In this branch of the system's relationships, as in others, it was true that the precedents established during 1914 were highly influential and that what was then determined with regard to the attitude of the Chief Executive toward the federal reserve system was likely to continue to hold good President Wilson from the beginning adopted an attitude of total aloofness. Although from the

very outset, there were questions before the federal reserve system which deeply affected the welfare of the administration, or of any administration that might be in office, as well as the future of the nation, and although the issues relating to banking and currency were of an urgency never before equaled, it early proved that the White House did not care to entertain any close relationship with the Federal Reserve Board or its members. The barriers of official reserve and red tape were strongly established against the Board, and it was placed in the same hierarchical position which had long before been assigned to other administrative boards. Nor was this, as many have supposed, merely an outgrowth of the President's own temperament. To one who raised the question with him why he had not permitted a larger degree of access on the part of the Board, he responded that it was his theory of the work of such an organization that, after being appointed under the terms of a specific statute, it should proceed to administer that statute without interference from, or consultation with, the Executive save on exceptional occasions. Unquestionably, this was a wholly defensible attitude and one which it would be hard to criticize, provided of course that no suggestions, intimations, or opinions were to be indirectly conveyed to the Board regarding probable presidential views.

White House Influence

These, however, seemed to come through the head of the Treasury. Could the Board question that they came by, and with the distinct knowledge or request of, the President himself? To do so would, of course, have been to imply bad faith on the part of the Secretary of the Treasury, or at all events the assumption of an authority which was not warranted by the circumstances of the case. It was therefore necessary to accept the Secretary of the Treasury as acting in place, or by authority, of the President himself, and in this way a very different

relationship between the Secretary of the Treasury and the Board than had been expected was built up, while communication with the President became unusual and in ordinary circumstances impossible. How differently this relationship might have been managed was often apparent at times when the duties of the Secretary of the Treasury took him away from the city, and when therefore communication was occasionally had direct with the White House. On such occasions, the Board found the President straightforward and decisive in his views and disposed to discuss pending questions in a businesslike and simple manner. A notable example of the kind was afforded by the necessity of adopting a policy with respect to the discounting of British Treasury notes, a matter to be discussed more fully in a later chapter. But there were other instances of less importance. The Board, the banks of the country, and the nation as a whole suffered from the lack of direct communication with the White House and through the interposition of Treasury intermediation. The evils of the case were to grow worse after the close of the Wilson administration, thus demonstrating that the harm of the situation lay in the plan of relationship itself and did not depend upon the special traits of individuals, whether in the White House or in the Treasury or in the Board itself. How to develop a satisfactory relationship between the banking system, the Treasury, and the head of the Administration, which should give due weight to all proper considerations of public policy in connection with banking, yet should avoid the evils of political influence, remains an unsettled problem which must soon be dealt with.

APPENDIX TO CHAPTER XXXVI

MEMORANDUM PREPARED BY A MEMBER, AUGUST, 1915

In view of the apprehension manifested by some of the southern farmers and business men regarding the marketing of the cotton crop

now approaching maturity, it is well to make comparison between the conditions affecting the cotton market that prevailed last August and those existing at the present time. For the sake of greater clearness this comparison will be made in parallel columns.

AUGUST, 1914

The shock resulting from the sudden outbreak of war between Great Britain, Russia, France, Serbia and Japan on one side and Germany and Austria-Hungary on the other, created a financial crisis throughout the world and paralyzed ocean transportation at a time when grain and other crops were moving to the ports for shipment abroad. Bankers and merchants in the United States owed England and the Continent on current account about \$150,000,000. Owing to lack of shipping facilities this indebtedness could not be liquidated in a normal manner by exporting commodities and in many cases gold settlements were demanded, so that the excess of our gold exports over imports from June 1st to December 30, 1914, amounted to \$156,287,454.

Maturing grain crops in the south insufficient for home consumption.
Modern corn crop and good wheat crop in the west.

Federal Reserve Banks not organized.

Cotton and Stock exchanges closed and all financial centers in fear of an avalanche of stocks, bonds and mortgages returned to this country by Europe for sale. Lack of ability or disposition to make loans on cotton.

Interest rates throughout the country abnormally high, and while there was no longer a call-loan market, rates on what had been call-loans and $2\frac{1}{2}\%$ were advanced to 6 and 8%.

Trade in textiles dull—demand poor.

JULY, 1915

The war continues, the number of belligerents being increased by the addition of Turkey on the side of the Entente allies and by Italy on that of the Entente powers.

Germany's and Austria's warships confined in the North Sea, Baltic and Adriatic. Then commerce-destroying cruisers in other seas have been either destroyed or interned. German and Austrian merchant vessels interned in various ports throughout the world. The sea area surrounding the British Isles declared a war zone and blockaded by German submarines. About 90% of all trans-Atlantic commerce carried in British bottoms.

Current indebtedness of America abroad entirely liquidated. Trade balance in our favor for fiscal year ended June 30th more than \$1,000,000,000. Excess of gold imports over exports January 1, 1915, to June 30, 1915 \$140,070,000.

Very large southern crop of corn in sight and increased crops of other grains.

Large corn and wheat crops in the west.

Federal Reserve Banks in operation.

All exchanges doing active business in a normal way.

Gradual absorption at advancing prices of American securities held in Europe. Such sales by Europe not discouraged and perhaps necessary as a basis for credits here for purchases of foodstuffs, cotton, and supplies.

Money rates abnormally low, and banks generally report large surplus of loanable funds. Trade balances and gold movement in our favor and banks in all centers holding much money available for invest-

AUGUST, 1914

General industrial depression, closing of mills, curtailment of production and much labor without employment

Railroad earnings decreased rapidly

Unusually large use of fertilizer, and heavy borrowings on cotton crop in advance of its preparation

Cotton acreage 37,400,000 acres, which produced, including linters, approximately 17,000,000 bales

JULY, 1915

ment No fear of our having to make further payments to Europe Textile trade fairly good Some complaint of lack of dyestuffs Agitation for manufacture of dyes in this country

Improved business conditions, mills re-opened, labor well employed Railroad earnings increasing with good prospects for the remainder of the year Steel mills active Better business in coal and iron

Forty per cent reduction in fertilizer used, and crop produced at minimum of cost

Cotton acreage 31,535,000 acres Estimates on growing crop run from 11,000,000 to 13,000,000 bales, with the probabilities favoring the lower figure

The Financial Chronicle reports figures as follows up to July 10th

		1914 (bales)		1915 (bales)
Since August 1st		10,497,210	Port Receipts	10,332,026
" " "		338,689	Port Stocks	801,014
" " "		7,415,224	Interior Receipts	8,081,343
" " "		158,507	Interior Stocks	515,000
" " "		14,722,372	Amount brought into sight	15,089,180
" " "		2,796,106	Northern spinners takings	3,130,946
" " "		2,949,000	Southern consumption	2,954,000
		5,745,106	Total American	6,084,946
" " "		3,438,524	Exports to Great Britain	3,769,230
" " "		1,064,533	Exports to France	660,316
" " "		4,402,079	Exports to Continent	3,762,977
		8,905,136	Total Exports	8,192,523
		3,689,052	World's visible supply	5,435,168
		2,016,052	Of which American	3,812,168
		915,000	Liverpool Stocks	1,693,000
		788,000	Continental Stocks	902,000
		112,318	New York Stocks	244,194
		70,009	New Orleans Stocks	158,625
		68,350	On shipboard awaiting clearance	80,631

A bulletin from the Census Bureau recently issued gives these comparative figures

1914 (bales)		1915 (bales)
446,145	American consumption of cotton in June, exclusive of linters	514,800
1,156,599	Held by manufacturers June 30th	1,622,499
630,487	Held in independent warehouses	2,085,347
295,578	Exports, including linters	294,391
30,918,048	Cotton spindles active	31,220,593

Under the most adverse conditions conceivable, with demoralization in every money market with high interest rates, with emergency currency being issued daily in large volume, with enormous gold shipments abroad, and with crippled shipping facilities without adequate insurance protection and with ocean freights three to five times normal we began in August 1914, to market a crop of nearly 17,000,000 bales of cotton. Financial institutions already hard pressed, and fearing all manner of unforeseen contingencies, were unable and unwilling to make advances on cotton. In addition to this the southern farmers, who have this year planted record-breaking food crops, were faced with a deficiency in home grown foodstuffs, and were in many cases forced to sell cotton to pay off pressing indebtedness and to secure adequate food supplies.

A cotton brokerage house enumerates the bear arguments at this time as follows:

"An accumulation in the visible supply of about two and a half million bales more than normal."

"An accumulation in producers' hands of about 1,000,000 bales of last year's crop unmarketed."

"Absence of spinners' demand for forward shipment."

"Decline of cotton manufacturing in Germany and Austria, due to insufficient supplies of raw cotton," and

"The fear of the shutting off of all exports."

It may be remarked that the last three arguments were also made when last year's crop began to be marketed, and that while it was freely predicted that less than 3,000,000 bales would be exported during the cotton year ending August 31st, 1915 the figures at hand indicate that the amount will be in excess of 8,500,000 bales, and that while it was asserted that takings by mills would not possibly exceed 9,000,000 bales, the total will reach 13,500,000.

Attention is called to the fact that the high prices for cotton now prevailing in Germany and Russia, about 30c per pound, will attract cotton to those countries in spite of apparently insurmountable obstacles, just as high prices paid for cotton abroad during the Civil War made blockade running a steady business. There seems to be no

question that ample funds can be obtained to finance in a normal way a much larger volume of cotton than was taken care of last year, and that even if Germany and Austria-Hungary should be forced to suspend cotton manufacturing entirely, statistics show that the mills of the United States, Great Britain, Spain, Russia, Italy, Japan, China and India have spindles sufficient to absorb every bale of cotton that is likely to be grown

It should be noted that the reduction in American cotton acreage this year amounts to more than 5,000,000 acres, and that Egypt and India have also made radical reductions in cotton acreage. It is probable that the world's cotton crop, based on an average yield per acre, will be about 5,000,000 bales less than last year.

Theodore H. Price, one of the best informed cotton authorities, in his review of cotton and the cotton market in the last issue of his journal "Commerce and Finance", makes some pertinent observations on the present cotton situation, from which I quote

The prospective difficulties in the way of shipping the next crop are not due so much to the much talked of British "Order in Council" as to the high freights and insurance which are the result of German submarines and the fear that homicidal maniacs may put infernal machines or bombs on all outgoing vessels.

We are informed that the explosion aboard the Minnehaha has made it exceedingly difficult to get crews for the transatlantic voyages in either American or European ports even upon payment of a bonus and that the chance of being blown up in mid-ocean, is one that most sailors are refusing to take no matter how great the financial inducement offered.

The price of nearly everything, except cotton, grown or manufactured in the United States, has been advanced by the war and while it may be unavoidable, it does seem inequitable, that the South should be the only section compelled to accept a low price for its chief product while it has to pay more for all the things that it consumes.

Most of the Southern people realize that the sooner the war is over the sooner normal conditions will be restored in the cotton market, and they are willing to hold their cotton in the hope of this consummation if they can borrow money to pay their maturing debts.

That they may do this it is necessary that the money should be available and that the cotton should be in the custody of warehouses whose receipts are good collateral.

That the money will be forthcoming is assured by the present plethora of bank reserves.

The warehouse capacity of the South is now estimated at over 9,000,000 bales but in many Southern States archaic laws impair the collateral value of warehouse receipts.

In South Carolina and Texas this difficulty has been removed through the establishment of State warehouse systems.

In New Orleans there is sufficient warehouse capacity to hold almost all the cotton produced in Louisiana. The legislatures of Georgia and Alabama now in session are actively considering measures to meet the emergency, and the cotton producers of these states will no doubt be soon provided with modernized warehouse laws.

If the facilities so established are fully availed of a very large proportion of the crop can be carried almost indefinitely and meantime each day that passes brings the end of the war that much nearer.

The outlook is not therefore as hopeless as some profess to believe and we counsel those who are likely to need cotton during the coming season to commence buying whenever they can obtain supplies on the basis of eight cents in the South.

Last season was a disappointment to the calamitous extremist and we have little doubt that history will repeat itself.

Of course it is desirable that as broad a market as possible for cotton be established. That it is the earnest desire of the President, born in the south and a resident of that section in youth during the period of life when one's tenderest ties and most enduring friendships are formed to assist his native section in solving the problems now confronting it cannot be doubted, as the south's cotton problem is essentially national.

But it should be remembered that the President owes a higher duty to the south, to the whole country and to mankind at this juncture, than the establishment of cotton prices. Serious complications between this country and any great foreign power would certainly not enhance cotton values. No man is as familiar with the great world problems of today and the relationship of this country to them as is the President, and he may be trusted to do his duty as he sees it regardless of private appeals or public clamor.

Cotton unlike grain, is a commodity the market value of which depreciates in time of war, and the south as a producer of that commodity has suffered. The statistical position of cotton, however, is so much stronger than was the case a year ago, and financial and other conditions are so very much more favorable, that there can be no doubt that if the south will keep cool and will refrain from merely weakening its own position by unwise action the present nervousness regarding the market for the growing crop will soon disappear. Even in the face of all the adverse conditions during the past twelve months, the average price of cotton has been about what might have been expected for a 17,000,000 bale crop had there been no war, and there is every reason to believe that the average price of cotton during the next twelve months will be higher. The real question is, will southern merchants and southern bankers, and all others interested in southern trade, cooperate in securing for the cotton producers the benefit of this

average price, and will the cotton producers themselves do their part? My knowledge of southern character and of southern business conditions justifies a confident belief that an affirmative answer will be given

The cotton tragedy of 1914 will be succeeded in 1915 by nothing more serious than a drama

CHAPTER XXXVII

THE RESERVE SYSTEM AND THE STATE INSTITUTIONS

Problem of State Banks

From the beginning of the federal reserve system's organization, the question what to do with respect to the admission of state institutions had been troublesome. We have seen that it had figured in an important way during the early history of the Federal Reserve Act, when an effort had been made to confine the membership of the system definitely to national banks, which should practically be required to accept and retain such membership as a condition of the holding of their national charters. This attempt had been defeated as a result of the demand of state institutions that they be given full competitive power by being admitted to the system if they should think it best to apply for membership. The act had given them this authority, but it had vested the Federal Reserve Board with power to fix the terms upon which admission should be granted. Thus at the very outset of the Board's career, there was a call for determination of the conditions of state bank membership. The question proved to be an extremely knotty one, and one which subsequently affected both the act itself and the system as a whole in a profound way.

Attitude of State Banks

Undoubtedly there was very great difference of opinion among state banks regarding their policy in the matter. Some believed that the reserve system would be highly advantageous to them and that they ought to take membership in it as soon

as possible. Others were of the opinion that the question of membership was a matter of indifference. A few felt that it would be wise policy for strong state banks to federate themselves together and compete with or oppose the reserve system. The adoption of an act providing for a reserve system to be organized under the laws of New York had been suggested and even urged in New York City. As the year 1913 drew to a close, the understanding of the functions of the reserve system had become much more extensive and the competitive idea was largely laid aside. During the year 1914, as has been seen at another point, friction and irritation had developed partly in consequence of the districting of the country that had been carried out by the Organization Committee, partly in consequence of a feeling that the new system was likely to be very dictatorial. The outbreak of the war brought a new factor into the situation, and led a good many institutions to feel that it might be wise for them to join the system even though their prejudice was against it. During the late spring and early summer, about 90 state institutions, partly banks and partly trust companies, made application for membership, and when the Federal Reserve Board had finally attended to the absolutely essential details of preliminary organization, it found itself with this prospective body of members but without any definite policy regarding the conditions of admission. From about the first of October, 1914, onward, the issue was thus urgent what should be done with the pending applications.

Indecision of Board

Notwithstanding that an element in the Board was apparently disposed to act upon the applications immediately, granting conditional admission or perhaps working out in hasty form the terms upon which such admission would be granted on a permanent basis, the general feeling in the organization was opposed to immediate admission of the applying state banks and trust companies. Considerable curiosity and uncer-

tainty naturally prevailed among these institutions and others which had had in mind the question of becoming members. Probably a sentiment of pique or irritation was developed in consequence of the Board's apparent indisposition to admit them. It was natural that institutions knowing little or nothing of the vast amount of detail required in adjusting the Board's preliminary organization, should have entertained some such sentiment, and doubly regrettable that no effort was made by the Board itself to reassure these prospective members regarding its feeling in the matter. Protracted delay at all events had the effect of leading to another reaction of sentiment. The suspension of specie payments which followed the outbreak of the war was mitigated in various ways, and did not prove as immediately disastrous as had been the case on some former occasions. Moreover, it was soon evident that the inconvenience caused by British demands for coin would shortly disappear and that conditions would return more or less nearly to normal. This perception undoubtedly dulled the keenness with which some state institutions had been disposed to view the question of membership, and inclined them to hold off. Thus, before the Board had actually reached the point where it was ready to offer any definite suggestions or make any fixed requirements regarding membership, it began to receive letters from those who had previously filed applications, withdrawing such applications. Eventually the entire list melted away. Meanwhile tentative regulations governing membership had been drafted and sent out in confidence.¹

Opposition of Influential Bankers

The opposition of influential bankers had now begun to take tangible form in connection with the question of state bank membership. A good many doubtless feared that if a number of state institutions should enter the reserve system, the result would be to force others into it, or at least start a

¹See Appendix A to this chapter.

movement toward membership whose effect might be to compel reluctant or hesitant state banks to join the system whether they liked it or not. Accordingly a definite movement was initiated whose purpose it was to negotiate with the Board and to demand from it positive pledges permitting the withdrawal of state institutions which had once joined, and also pledges respecting the continued enjoyment of all local privileges by members which might enter the system. On December 8, 1914, a delegation of state bankers made a formal appearance before the Board and at that time presented argument whose substance was as follows ²

STATEMENT OF BANKERS' COMMITTEE

We feel that sufficient time has not elapsed since the appointment of our committee by the president of the American Bankers' Association, said committee being appointed only on November 9, to have given proper and full consideration to the weighty problems involved in this subject and to have arrived at any conclusion in the settlement of the problems.

The resolution passed by the American Bankers' Association, and under which this committee is acting, had for its object the suggestion of such change or changes in the Federal Reserve Act as would permit state chartered institutions to enter the System and, as before stated and for the reasons given, the committee has been unable to offer any suggestions to the purpose for which they were appointed, and if, in offering some suggestions as to the rules and regulations to be promulgated by the Federal Reserve Board, they have strayed afield from the purpose of their appointment, they would plead their desire of full co-operation with the Government in the furthering of the banking interests of the country by doing everything in their power to assist the Federal Reserve Board in the determination of the problems with which they are now confronted.

² Those present included Messrs Hamlin, Williams, Harding, Warburg, Delano, and Miller of the Federal Reserve Board, and the following bankers:

W H McCarter, president of Fidelity Trust Company, Newark, N J.

John W Platten, president of United States Mortgage and Trust Company, New York City

Oliver C Fuller, president of Wisconsin Trust Company, Milwaukee, Wisconsin.

A A Jackson, vice president of Girard Trust Company, Philadelphia, Pennsylvania

John H Mason, vice president of Commercial Trust Company, Philadelphia, Pennsylvania

B F Saul, president of Home Savings Bank, Washington, D C

Geo E Lawson, vice president of Peoples State Bank, Detroit, Michigan

While the trust companies have given a great deal of consideration involving the subject, frankly we are compelled to admit, for the reasons outlined in the beginning of my remarks, viz the short time we have had between the date of our appointment and the date of this meeting, that we have been unable to arrive at any conclusion among ourselves by which we could make any suggestions to you looking toward such amendments as might be made to the Act which would encourage trust companies to enter the System

Since, however, it is the intention of the Federal Reserve Board to promulgate certain rules and regulations, it may not be inappropriate to bring to your attention one or two thoughts which have occurred to us and which we would like to suggest to you for your consideration

POWERS AND RESTRICTIONS

Fourth "State banks and trust companies may continue to exercise those banking or trust company powers granted them by their state charters when such powers are not in conflict with the limitations imposed by the Federal Reserve Act or the regulations of the Board No power however granted by a state charter which is not customarily exercised by a bank or trust company and which is not incident to the business of a bank or trust company shall be exercised by any association (incorporated under the laws of any State) which becomes a member of the Federal Reserve System The Reserve Board reserves to itself the determination as to whether these unusual powers are admissible and consistent The applying bank must file with its application, as an exhibit, its statement showing powers granted to it by its state charter and those powers which it desires and intends to exercise "

It occurs to us that it may be difficult to determine what are the powers usually exercised by trust companies Their powers are enumerated in the several state statutes under which they are incorporated There is considerable difference between the powers granted such companies by the different state laws In addition to this some of the trust companies are operating under private charters and exercising not only the powers given under such charters, but also the powers given under the general statutes

CHOICE OF FUNCTIONS

Under these conditions an applying trust company will be confronted with the necessity of immediately determining what powers

it would like to exercise in the future and possibly of being compelled to discard some of the powers granted by its charter because the Federal Reserve Board, which is a continuing power, might be of the opinion that some of these powers not customarily exercised were inconsistent with the Federal Reserve System and therefore inadmissible

Our disposition being in every respect that of supporting the Federal Reserve Board and the recent banking legislation we had thought possibly, after an opportunity had been afforded to the trust companies of watching the operations of the Act as applied to National Banks, that later on any state chartered institution would be able to enter the System and, after a fair trial of the same, if it so desired, might retire therefrom. As the law now reads this cannot be done. The Federal Reserve Act opens the door for voluntary entry of state institutions, but does not permit voluntary exit except through liquidation.

SEC 10 "The Federal Reserve Board will from time to time make such amendments and adopt and publish such additional regulations and by-laws as may be deemed necessary and advisable."

This regulation seems to us to contain elements of great danger to state chartered institutions entering the System and to impose hardships upon them which are not imposed upon national banks, for the duties, the privileges, and the limitations as applied to national banks in the Federal Reserve Act are defined and prescribed, while under this regulation a future Federal Reserve Board may prescribe regulations for the conduct and management of state chartered institutions which may be difficult to comply with, and the above mentioned class of institutions would have no remedy or power to escape their enforcement except again by liquidation.

In offering these comments, we trust that you will realize that, for the reasons I have already stated, they merely represent the personal views of the members of the legislation committee of the Trust Company Section.

Failure to Conciliate State Banks

So strong an impression was left on the mind of the Board by the opposition evidently existing among influential state bankers, that it once again put aside the whole question of membership and devoted itself to other matters, definitely recognizing that the first opportunity of getting large acces-

sions to membership had now passed by and that since such was the case there was no further haste in the matter. It now sought to obtain as general an expression of opinion from state institutions as possible concerning the terms upon which they should be accepted as members. These views were transmitted at intervals during the forepart of 1915, and eventually gave rise to a regulation issued in June of that year, and governing the conditions under which state institutions might be admitted.³ The general ideas embodied in this regulation included liquidity of position and soundness of assets as a basic necessity; acceptance of some general requirements designed to put the state banks upon a footing of equality with national institutions (such as limitation of the acceptance power, restriction of the organization of branches, and a few others); general observance of the Board's requirements with respect to essential matters of management; observance of the same general requirements with respect to limitation of the amount of any single loan as were required in the National Bank Act (subject to modification in special cases by the Board); and regular examination either through persons representing the Board or through state authorities working in collaboration with the Board. These regulations practically conceded everything that the state bankers had asked. They made specific provision that a state bank might withdraw from the system upon giving six months' notice, and when so withdrawing should be promptly paid back its contribution to capital, its reserves, and its accrued dividend. Indeed, so far did the Board go in this regulation that many national banks felt that a serious blow had been dealt them. Not a few national bankers were disposed to inquire of what advantage it was for them to continue in the national system when state banks could gain all the advantages (as they thought) accruing to members of the federal reserve system without submitting to

³ See Appendix B to this chapter

more onerous restriction. By the middle of 1915, however, the opposition propaganda whose purpose it was to prevent extensions of the federal reserve system had become widely diffused. Some large state banks went so far as to announce that they could do all that any federal reserve bank could and to solicit "members" (correspondents) with the pledge that they would undertake to perform exactly the same services that were rendered by reserve banks. These extreme manifestations of hostility had no immediate effect, but the net outcome was to prevent, for the time being, the extension of the membership of the reserve system. Up to the close of the year 1915, the total number of state bank members was only 32. So far as the organization efforts of the Federal Reserve Board related to state institutions, they had been a complete failure.

Relations with National Members

The fact that it had proved impossible to gain the support of the state institutions was not of primary importance. The reserve banks were large enough and had sufficient resources to discharge the duties for which they were formed, if they could gain the support of their own principal members in an active and loyal way. This, however, appeared to be almost out of the question. It was a matter of common talk, though not susceptible of proof, that a good many bankers had expressed the determination not to do any business with the reserve banks. A few placed "complimentary rediscounts" with their local institutions for the purpose of showing good will, but they did not go much further than this. There was opposition to the working of the reserve banks in a good many particulars. Undoubtedly there were conditions which more or less explained a hostile attitude of this description, as will be seen when the subject of collections and the treatment of commercial paper is dealt with at a later point. These, how-

ever, were matters of operation, and at the present moment it is sought to deal only with questions of organization. How far unsatisfactory operation or lack of service tended to interfere with the progress of the organization, is a question which may be deferred for future treatment. At this point it is to be noted that the years 1914 and 1915 did not succeed to more than an extremely moderate degree in developing a situation in which definitely good relations existed between the Federal Reserve Board and the member banks, or on the whole between the reserve banks themselves and their members. This factional or "disgruntled" attitude was well illustrated in the constant effort that was made to bring about the modification of the law and regulations under which the system existed.

Attempt to Modify Reserve Requirements

Perhaps the most striking manifestation of this sort of hostility was seen in the systematic attempt that was made to secure a modification of reserve requirements. The Board had not been long in existence when it began to receive suggestions—sometimes couched in dictatorial language, and originating with bankers—to the effect that it ought to endeavor to obtain a further extension of the Aldrich-Vreeland Law. This was for the alleged reason that, whereas the Aldrich-Vreeland Law had shown that it would "work," the Federal Reserve Act had not shown any such practical qualities. Some bankers even had the courage to appear before the Board in person, demanding in effect that the organization should request Congress to condemn it to death. A more practical type of demand was seen in the petition of a considerable number of bankers representing the reserve cities that the Board should seek from Congress a modification of the reserve transfer requirements of the law. What the bankers desired was that further transfers of reserves to reserve banks should be abandoned, and that in lieu thereof there should be substituted a

provision to the effect that any bank might continue to maintain with a reserve agent in a reserve city not more than 300 miles distant from its home office, a proportion of its reserves equal to what was then permitted by law to be carried on deposit there. Fears almost amounting to threats as to what would happen if the requirement of reserve transfers should be maintained were expressed in many quarters, and the insistent demand for legislation of this kind became more intense as the date of transfer approached. The Board, however, paid no attention to it, and the reserve question eventually settled itself through the action of Congress in adopting a measure which altered the reserve requirements and directed a prompt termination of the practice of counting balances with reserve agents as reserves. A further and more extensive discussion of this action will, of course, be necessary at the appropriate point and it is referred to here merely by way of indication of the eventual settlement of the bankers' demands. The Federal Reserve Board itself never in any overt way yielded to the demands of the bankers as thus preferred, and never recommended either the extension of the Aldrich-Vreeland Law or the retention of reserve balances with the local member banks in reserve cities throughout the country. By refusing to make any such concession, it at all events declared itself in favor of a thorough and complete test of the existing machinery, and to that extent showed to the banking community an inclination to abide by the fundamentals of the system, although it never returned any formal answer to the various demands that were placed before it.

Modifications of Structure

While the external efforts at modification of the structure of the system had thus failed, and while the attempt to induce changes in internal organization were thus unsuccessful, the fact that there had been no provision for state institutions

during the early months, and that none had joined, save in the sporadic instances already referred to, naturally limited the development of the organization and to some extent impaired its prestige. From the outset there had been more or less doubt among the reserve banks themselves as to how far they would succeed in overcoming local opposition. The fact that state banks did not join the system, that the directoral selections aroused but little interest and that the local bankers throughout the country were constantly engaged in endeavoring to secure modifications of the essential sections of the act, tended to bring about deterioration of functions, or rather to prevent functions from developing actively, notwithstanding that they might have been of considerable service. In none of the reserve banks was there any apparent inclination to do anything that was opposed by local institutions, and during the first two years of the life of the system it often seemed that the reserve banks, instead of becoming supervising agencies, were far more nearly channels of communication through which local members expressed their wishes and focused their demands upon the Board at Washington.

APPENDIX A TO CHAPTER XXXVII

FEDERAL RESERVE BOARD

November 6th, 1914

SECRETARY TO THE BOARD

My dear Mr. Secretary —

I am handing you copy of re-draft of the regulations and by-laws prescribing conditions under which state banks and trust companies may become members of the Federal Reserve System which will be presented to the Board for consideration.

I desire to call particular attention to the 4th, 5th and 8th paragraphs, which contain new matter.

Respectfully,

(Signed) M. ELLIOTT

REGULATIONS AND BY-LAWS OF THE FEDERAL RESERVE BOARD, PRE-
SCRIBING CONDITIONS UNDER WHICH STATE BANKS AND
TRUST COMPANIES MAY SUBSCRIBE TO THE STOCK AND
BECOME MEMBERS OF FEDERAL RESERVE BANKS

Washington, D C

1914

REGULATION No

Section 9 of the Federal Reserve Act reads in part, as follows

Any bank incorporated by special law of any State, or organized under the general laws of any State of the United States, may make application to the reserve bank organization committee, pending organization, and thereafter to the Federal Reserve Board for the right to subscribe to the stock of the Federal Reserve bank organized or to be organized within the Federal Reserve district where the applicant is located. The organization committee or the Federal Reserve Board, under such rules and regulations as it may prescribe, subject to the provisions of this section, may permit the applying bank to become a stockholder in the Federal Reserve bank of the district in which the applying bank is located. Whenever the organization committee or the Federal Reserve Board shall permit the applying bank to become a stockholder in the Federal Reserve Bank of the district, stock shall be issued and paid for under the rules and regulations in this Act provided for national banks which become stockholders in Federal Reserve Banks

Pursuant to the provisions of this section, the Federal Reserve Board has prescribed the following regulations and by-laws specifying the conditions under which State banks and trust companies may become members of Federal Reserve banks

APPLICATION FOR STOCK

First—Any State bank or trust company eligible to membership in a Federal Reserve bank under the Federal Reserve Act and desiring to subscribe to the capital stock of the Federal Reserve bank organized in the district which includes the place of business of such State bank or trust company shall under authority of its Board of Directors, to be evidenced by a proper resolution of the Board, make application for an amount of capital stock in such Federal Reserve bank equal to 6 per cent of the unimpaired capital stock and surplus of such State bank or trust company. This application must be accompanied by a statement showing the assets and liabilities of such State bank or trust company listed on forms approved by the Federal Reserve Board. These forms will be furnished upon request by the Chairman of the Board of the Federal Reserve bank of the district in which the applying bank is located.

The Board of Directors or a committee composed of not less than five members of such Board shall certify that in their opinion the assets listed in the manner prescribed by the Federal Reserve Board represent actual existing values and that in the opinion of said Board none of such assets are carried at an excessive valuation on the books of said bank

State banks and trust companies shall also file with their applications for membership copies of their charters, with amendments, and a digest thereof showing the powers (granted by such charters and amendments) classified to indicate

(a) Those powers which such banks and trust companies have exercised and desire to continue to exercise

(b) Those powers which, while granted, have not been exercised and which such banks and trust companies will not desire nor attempt to exercise as members of the Federal Reserve System

EXAMINATION

Second—The Federal Reserve Board will in all cases require a special examination of the applying bank by an examiner to be designated by the Board

ASSOCIATIONS ELIGIBLE FOR MEMBERSHIP

Third—Only those banks which have an unimpaired capital sufficient to entitle them to become national banking associations under the provisions of the National Bank Act shall be considered as eligible to membership in a Federal Reserve bank

In accordance with section 5138, U S Revised Statutes, as amended by the act of March 14, 1900, State banks or trust companies in order to be eligible to membership must have unimpaired capital stock, as follows

In cities or towns of less than 3,000 inhabitants, \$25,000

In cities or towns of more than 3,000 inhabitants but less than 6,000 inhabitants, \$50,000

In cities of more than 6,000 inhabitants but less than 50,000 inhabitants, \$100,000

In cities of more than 50,000 inhabitants, \$200,000

POWERS AND RESTRICTIONS

Fourth—State banks becoming members as such under the provisions of section 9 of the Federal Reserve Act and retaining their State charters shall be subject to the provisions of section 9 and to

such other provisions of the Federal Reserve Act as are applicable thereto

State banks and trust companies may continue to exercise those banking or trust company powers, granted them by their State charters, when such powers are not in conflict with limitations imposed by the Federal Reserve Act. No power, however, granted by a State charter, which is not ordinarily exercised by a bank or trust company or which is not incident to the business of a bank or trust company, shall be exercised by any association (incorporated under the laws of any state) which becomes a member of the Federal Reserve System. The applying bank must file with its application as an exhibit a statement showing powers granted to it by its state charter and those powers which it desires and intends to exercise

INVESTMENTS BY STATE BANKS AND TRUST COMPANIES

Fifth—Inasmuch as the Federal Reserve Act limits the amount to be loaned to any one person, firm or corporation by a state bank as a member of the Federal Reserve System but does not specifically prescribe the class and character of investments to be made, such banks or trust companies may invest in or make loans on real estate or other investments within the limitations prescribed by the laws of the State within which such bank or trust company is located, provided, such investments are so made that in due course of business they may be liquidated for an amount which will fully protect the creditors and stockholders of such association, and no such association will be permitted to become or continue a member of the Federal Reserve System if its resources are invested in such long time and non-liquid investments in such a proportion as to endanger the solvency of such association or to cause an impairment of its capital, and the character of all such investments will be taken into consideration in determining the value at which they may be carried on the books of the association

CONVERTED STATE BANKS AND TRUST COMPANIES

Sixth—Whenever a State bank or trust company shall become converted into a national bank under the provisions of Section 8 of the Federal Reserve Act, it shall, at the same time that it files its organization certificate with the Comptroller of the Currency, execute and file with the Federal Reserve bank of its district an application for an amount of stock equal to six per cent of its unimpaired capital and surplus. If such bank or trust company desires to act as trustee,

executor, administrator or registrar of stocks and bonds, its application for stock in the Federal Reserve bank shall be accompanied by an application to the Federal Reserve Board for permission to exercise these powers

Seventh—Whenever a State bank or trust company with established branches shall make application for conversion into a national bank and shall desire to retain such branches, such State bank or trust company shall comply with section 5155, U S Revised Statutes, which reads as follows

"It shall be lawful for any bank or banking association organized under State laws, and having branches, the capital being joint and assigned to and used by the mother-bank and branches in definite proportions, to become a national banking association in conformity with existing laws, and to retain and keep in operation its branches, or such one or more of them as it may elect to retain, the amount of the circulation redeemable at the mother-bank, and each branch, to be regulated by the amount of capital assigned to and used by each "

Eighth—State banks or trust companies applying for membership in the Federal Reserve System under section 8 of the Federal Reserve Act by conversion into national banking associations, or applying for membership under section 9 as State banks will, if otherwise found to be eligible, be given a reasonable time within which to adjust the loans and investments of such banks to conform to the requirements of the Federal Reserve Act and other laws of the United States applicable thereto. Any bank applying for membership and having loans to any one person, firm or corporation in excess of the limit allowed by the Federal Reserve Act or other loans and investments prohibited by such act shall before being admitted to membership, give satisfactory assurance to the Committee or to the Federal Reserve Board that such loans and investments will be eliminated or made to conform to the provisions of the Federal Reserve Act and other applicable laws not later than

The condition of the applying bank or trust company and the general nature of its business will be considered by the Federal Reserve Board in each case in determining whether such banks shall be admitted to membership

Ninth—All applications must be addressed to the Federal Reserve Board but must be forwarded to the Chairman of the Board of the Federal Reserve bank of the district in which the applying bank is located who will transmit same to the Federal Reserve Board with his recommendation

Tenth—The Federal Reserve Board will from time to time adopt and publish such additional regulations and by-laws as may be deemed necessary and advisable

FEDERAL RESERVE BOARD

By

Secretary

Governor

APPENDIX B TO CHAPTER XXXVII

REGULATION OF FEDERAL RESERVE BOARD GOVERNING MEMBERSHIP
OF STATE BANKS

I STATUTORY REQUIREMENTS

Specific provisions of the Federal Reserve Act applicable to State banks and trust companies which become member banks are quoted at

II BANKS ELIGIBLE FOR MEMBERSHIP

A State bank or a trust company to be eligible for membership in a Federal Reserve Bank must comply with the following conditions—

(1) It must have been incorporated under a special or general law of the State or district in which it is located

(2) It must have a minimum paid-up unimpaired capital stock as follows

In cities or towns not exceeding 3,000 inhabitants, \$25,000

In cities or towns exceeding 3,000 but not exceeding 6,000 inhabitants, \$50,000

In cities or towns exceeding 6,000 but not exceeding 50,000 inhabitants, \$100,000

In cities exceeding 50,000 inhabitants, \$200,000.

III. APPLICATION FOR MEMBERSHIP

Any eligible State bank or trust company may make application on Form 83, made a part of this regulation, to the Federal Reserve Agent of its district for an amount of capital stock in the Federal Reserve Bank of such district equal to 6 per cent of the paid-up capital stock and surplus of such State bank or trust company *

* Three per cent has already been called from national and other member banks, but the remainder of the subscription or any part of it shall be subject to call if deemed necessary by the Federal Reserve Board

Upon receipt of such application the Federal Reserve Agent shall submit the same to a committee composed of the Federal Reserve Agent, the Governor of the Federal Reserve Bank, and at least one other member of the board of directors of such bank, to be appointed by such board, but no Class A director whose bank is in the same city or town as the applying bank or trust company shall be a member of such committee. This committee shall, after receiving the report of such examination as may be required by the Federal Reserve Bank in pursuance of directions from the Federal Reserve Board, consider the application and transmit it to the Federal Reserve Board with its report and recommendations.

IV APPROVAL OF APPLICATION

In passing upon an application the Federal Reserve Board will consider especially—

(1) The financial condition of the applying bank or trust company and the general character of its management

(2) Whether the nature of the powers exercised by the said bank or trust company and its charter provisions are consistent with the proper conduct of the business of banking and with membership in the Federal Reserve Bank

(3) Whether the laws of the State or district in which the applying bank or trust company is located contain provisions likely to interfere with the proper regulation and supervision of member banks

If, in the judgment of the Federal Reserve Board, an applying bank or trust company conforms to all the requirements of the Federal Reserve Act and these regulations, and is otherwise qualified for membership, the Board will issue a certificate of approval. Whenever the Board may deem it necessary, it will impose such conditions as will insure compliance with the act and these regulations. When the certificate of approval and any conditions contained therein have been accepted by the applying bank or trust company stock in the Federal Reserve Bank of the district in which the applying bank or trust company is located shall be issued and paid for under the regulations of the Federal Reserve Act provided for national banks which become stockholders in the Federal Reserve Banks.

V POWERS AND RESTRICTIONS

Every State bank or trust company while a member of the Federal Reserve system—

(1) Shall retain its full charter and statutory rights as a State bank or trust company, and may continue to exercise the same func-

tions as before admission, except as provided in the Federal Reserve Act and the regulations of the Federal Reserve Board, including any conditions embodied in the certificate of approval

(2) Shall invest only in loans on real estate or mortgages of a character and to an extent which, considering the nature of its liabilities, will not impair its liquid condition

(3) Shall adjust, to conform with the requirements of the Federal Reserve Act and these regulations, within such reasonable time as may be determined by the Board in each case, any loans it may have at the time of its admission to membership which are secured by its own stock, or any loans to one person, firm, or corporation aggregating more than 10 per cent of its capital and surplus or more than 30 per cent of its capital, or any real estate loans which, in the judgment of the Federal Reserve Board, impair its liquid condition

(4) Shall maintain such improvements and changes in its banking practice as may have been specifically required of it by the Federal Reserve Board as a condition of its admission, and shall not lower the standard of banking then required of it, and

(5) Shall enjoy all the privileges and observe all those requirements of the Federal Reserve Act and of the regulations of the Federal Reserve Board applicable to State banks and trust companies which have become member banks

VI WITHDRAWALS

Any State bank or trust company desiring to withdraw from membership in a Federal Reserve Bank may do so twelve months after written notice of its intention to withdraw shall have been filed with the Federal Reserve Board. The Board will immediately notify the Federal Reserve Bank of the receipt of such notice. At the expiration of said twelve months, such bank or trust company shall surrender all of its holdings of capital stock in the Federal Reserve Bank, which stock shall then be canceled and the withdrawing bank or trust company shall thereupon be released from its stock subscription not previously called. Such bank or trust company shall, immediately upon the cancellation of its stock, cease to be a member of the Federal Reserve Bank, and the Federal Reserve Bank shall then refund to such bank or trust company a sum equal to the cash-paid subscription on the shares surrendered, with interest at the rate of one-half of one per centum per month computed from the last dividend, if earned, not to exceed the book value thereof, and the reserve deposits, less any liability of such member to the Federal Reserve Bank. *Provided, That*

no Federal Reserve Bank shall, except by the specific authority of the Federal Reserve Board, cancel within the same calendar year more than 10 per cent of its capital stock for the purpose of effecting voluntary withdrawals during that year. All applications, including therein any on which action may have been deferred because in excess of the aforesaid 10 per cent limitation, will be dealt with in the order in which they were originally filed with the Board.

Any State bank or trust company desiring to withdraw from membership at the expiration of the twelve months' notice, notwithstanding the fact that the Federal Reserve Bank has previously canceled 10 per cent of its stock during the same calendar year, may do so. In such case, however, the Federal Reserve Bank shall not be required to repay to the withdrawing bank or trust company the sums due as above, until such time as its stock would have been canceled had it not exercised this option. The Federal Reserve Bank shall, however, give a receipt for the stock surrendered.

VII EXAMINATIONS

Every State bank or trust company, while a member of the Federal Reserve system, shall be subject to such examinations as may be prescribed by the Federal Reserve Board in pursuance of the provisions of the Federal Reserve Act.

In order to avoid duplication, the Board will exercise the broad discretion vested in it by the Act in accepting examinations of State banks and trust companies made by State authorities wherever these are satisfactory to the Board and are found to be of the same standard of thoroughness as national bank examinations and where in addition satisfactory arrangements for co-operation in the matter of examination between the designated examiners of the Board and those of the States already exist or can be effected with State authorities. Examiners from the staff of the Board or of the Federal Reserve Banks will, whenever desirable, be designated by the Board to act with the examination staff of the State in order that uniformity in the standard of examination may be assured.

VIII FUTURE REGULATIONS

The Federal Reserve Board reserves the right to make such amendments and adopt and issue, from time to time, such further regulations authorized by the act as it may deem necessary, but no amendment of section VI of these regulations, relating to voluntary withdrawals, shall take effect until six months after its adoption and issue by the Board.

CHAPTER XXXVIII

A SURVEY OF EXPERIENCE

Importance of Organization

It is now worth while to review the history of the organization of the federal reserve system for the purpose of forming some general conclusions regarding it. An overestimate of the significance of what was done during the year 1914 could hardly be made. The adoption of the act during the year 1913 unquestionably marked that year as a notable era in the whole financial history of the United States. Unexpected and sweeping as the victory had been, it had laid the foundation for a complete transformation of the old banking system of the United States, and the substitution of something better than the emergency makeshifts which had been advocated not only by bankers and "reform organizations" but also by scientific students who for years past had been considering different phases of the situation, although with little hope that in any near future Congress could be induced to take definite action.

However, it must be admitted that, great as this progress had been, the actual work of organization had neutralized no small share of it. The unsatisfactory character of the districting of the country had impaired the prestige of the system and had necessitated the doing of much work by the Federal Reserve Board at a later date, with a view to a rectification of blunders committed. The action of the President in choosing the members of the Reserve Board itself had not been very happy, since either through accident or design on the part of his advisers

he had succeeded in assembling a rather discordant organization. This organization itself had been guilty of some capital errors of omission and of commission, and as a result the closing of the year 1914 found the reserve banks with a skeleton organization whose effective working was still to be demonstrated, while considerable obstacles had made their appearance in a variety of directions.

Advent of War a Crucial Factor

Added to these unfavorable conditions was the fact that the world at large was now definitely engaged in warfare, and that, as later appeared, the United States was in no position to hold aloof and could not long do so. The coming on of the war had, as already seen, a very mixed influence upon the federal reserve system but it at all events was to result in giving to the system a much earlier and stronger growth than it could otherwise have had. That in this growth capital blunders were perpetrated is, of course, an obvious fact. The prominence given to such blunders, both during and immediately after the war when their consequences became more evident, naturally tended to hurt the growth of the system and thus to stunt the abnormal development already attained. Perhaps it would be a truthful generalization to say that the situation produced by the war was such as to bring to a head or to develop long-standing causes of differences of opinion, and to aggravate errors and evils which were inherent in our banking organization. In any case the war was a factor in the situation which could not have been eliminated. Even if the coming on of the war could have been foreseen, it would have been impossible to postpone the reorganization of the banking system. That, if anything, was rendered more urgent because of the war. In some aspects the system might have been modified and its formal organization could undoubtedly have been hurried forward. The postponement of organiza-

tion until after the war, which had been suggested by some, would have been absurd and out of the question. Thus the war had, as already stated, to be reckoned with and its conditions had to be met by the federal reserve system, but in meeting them the nature of the problem of banking reform was very largely altered.

Effect of Organization

The effect of what was done during the organization period, both good and bad, was to be lasting. It could not be easily reversed, for precedents were quickly built up within the system and then proved their ability to sustain themselves. Methods of work pursued by the Board, at first as matter of expediency, quickly crystallized into permanent procedure. Relations with member banks and with federal reserve banks, at first undertaken as a mere matter of temporary adjustment, quickly stereotyped themselves and proved difficult of reversal. The mere fact that war conditions so rapidly built up the system while it was still in a formative state, the more emphasized and extended the importance of what was being done at the outset. Of all this the Federal Reserve Board itself was largely unconscious, and it failed to develop a general policy looking to the future or designed to harmonize with the general trend of affairs. Because of this hand-to-mouth attitude, the Board soon lost its control over the financial situation and its potential authority in the government. The President shortly failed to give it any direct consideration, and almost from the very beginning communicated with it through the Secretary of the Treasury. Having thus allowed itself to assume the rôle of a subordinate bureau, the Board found it difficult to throw off this status and was eventually compelled to accept it more or less openly. This naturally gave a very distinct tone to all of the subsequent work of the organization, particularly during the war.

Attitude of Administration

A survey of the situation in the federal reserve system at the close of 1914 was not calculated to inspire very great confidence as to the future. It was true that the system had been organized more quickly and perhaps with less friction than there had been any reason to expect, especially if one considers the very serious obstacles which had been presented by the fact of banking hostility, partly arising out of the way in which the law was pushed through to adoption and partly out of the urgent and ready method which had been adopted in the districting and early organization of the new banks. But while this technical success had been enjoyed, a glance under the surface seemed to show the existence of serious danger and of reason for doubt regarding the future. The subsequent history of the federal reserve system cannot be understood without carefully bearing in mind the complex elements of opposition which had now been fully brought to light and which at the close of 1914 might well be expected to continue to make themselves felt as time went on. It is, therefore, worth while in retrospect to survey with some degree of attention the real nature of these difficulties.

Attitude of Board

It cannot be too strongly emphasized that a fundamental difficulty in connection with the federal reserve system was found in the make-up or composition of the Federal Reserve Board. Experience had shown that it did not consist of men whose primary interest was in scientific banking. Neither did it consist primarily of those whose acquaintance with the details of practical banking gave them technical familiarity with the operations which must be carried on by the system in order to be successful. The Board had an unquestionable bias against the system which it was set to administer, was doubtful of the success of the undertaking, was timid in its attitude toward the provisions of the law, was disinclined to take vigor-

ous forward steps for the purpose of setting the machinery in motion By this is not meant that the Board was in any sense recreant to its duty or indisposed to do the best it could, or in any sense representative of the "special interests" so often referred to, or desirous of handicapping the administration All these charges have been made or intimated at one time or another, though usually from irresponsible sources None of them had the slightest foundation The Federal Reserve Board was composed essentially of men with a distinct sense of public duty and a great desire to make a successful place for themselves in Washington They had as their motive to make a success of the system, and the difficulties which they had to and did face were in the main those which grew out of their own temperaments or lack of interest in such work or lack of experience in it Whatever they were, they were very great and the Board certainly during its early years never became a satisfactorily organized smooth-working administrative machine Whether those who originally determined upon the personnel of the Board consciously sought to accomplish this object or not, is a question which cannot be answered but which at least is worthy of consideration

Opposition of Banking Interests

The experience of the year 1914 had also made it very plain that the opposition of the banking interests had in no sense been lessened by the actual organization of the reserve banks and the appointment of the Federal Reserve Board About the utmost that could be said was that such antagonism had been partly stilled, but even this change was effected primarily due to the coming on of the European war The outbreak of the war and the attendant financial difficulties showed that it might well be necessary to have an emergency aid in case of need, and convinced some who had previously held an unfriendly attitude, that the federal reserve system would be in certain not improbable contingencies a very effi-

cient auxiliary to the existing banking system. This, however, was a view which was by no means general or universal and which was not sufficiently strongly held to mask the essential selfishness of many of the banking interests. They were unquestionably determined not to deal with the system any more than they could help. The functions of the reserve banks, they thought, should not be developed, or any further or extensive organization or enlargement of the reserve system effected, pending the time that necessity should point to this as a means of avoiding inconvenience or perhaps disaster. Bankers' associations and clearing houses were obviously unfriendly in spirit, although in many cases affording technical assistance even at considerable expense and inconvenience to themselves. The reserve system had obviously to find some means of combating or overcoming this indisposition to deal with it, and had in some way to convince the banking community that the system itself could be made an efficient integral part of the financial structure of the United States. In the absence of such demonstration or proof and of the cordial assent of the bankers of the country to the conduct of the enterprise, it seemed clear that the system might be nothing more than an expensive toy or at best a costly means of emergency relief availed of only very occasionally. The development of it as a central banking system adapted to the needs of the United States but following in its operations the experience of European countries, was manifestly a long way off. If this was to be accomplished, it would be accomplished only through service by the new banks and through generous recognition of such service by the rank and file of the banking community. The Federal Reserve Board was not, by temperament or inclination, much disposed to seek a means of popularizing the system, and the beginning of the year 1915 left it extremely doubtful how or under what conditions any such process of developing popular understanding and appreciation would be successful.

The Problem of the War

The more the general banking and financial situation of the country was considered, the more apparent it seemed that the time could hardly have been less propitious for the inauguration of the new system. The advent of the war, it was already seen, would leave very deep disturbances throughout the country, even if the conflict could, as many still thought it might, be terminated within a few months. It seemed impossible to foresee with any degree of approximation the effect of the war upon American finances. This now seems, as is always the case after the fact, almost an incomprehensible situation. Yet one needs only to run back in his own mind over the expressions which were used by financiers and economists during the early days of the war, to find abundant justification for it. Predictions that the United States would after the war find the competition of European nations almost intolerable, due to their increase in industrial efficiency, fears that the gold standard would immediately be abandoned in favor of some other "more scientific" standard, belief that our cost of production would be so enormously increased through war inflation as to make it impossible for us to compete with foreigners, and others of the same sort, were sanctioned during the years 1914-1915 by some who might have been expected to avoid such alarmist attitudes. Financially speaking, the gloomy prospects foreseen by some who asserted their belief in continued loss of gold or changes in rates of interest and in financing of securities that would upset conditions in the United States, were by no means so fantastic as the industrial and political predictions to which reference has already been made, but as things turned out they were nearly as well founded.

In all this confusion and uncertainty it was not strange that both the Federal Reserve Board and the several reserve banks should have been impressed with the thought that extreme conservatism and hesitation would be the part of

wisdom and that to press forward with new developments in a way which might have been thought wise in happier times was a course that could hardly be warranted. Thus the war, certainly during the early years, exerted upon the reserve system a peculiar effect. Reference has been made to some phases of this situation in a preceding chapter. What is sought at this point is merely to recall the fact of the war as an element in the banking system at the close of 1914 and to remind the reader of the results which inevitably flowed from it as a factor in early banking organization.

Mistakes of Administration

Hardly less serious in handicapping and crippling the growth of the system, were the mistakes of policy adopted by the administration, including both the President and the Treasury Department. It was a fundamental error to seek at the outset to make the banking system subordinate to or dependent upon the Treasury Department, an error whose effects at that time could hardly be appreciated but which must later produce fruits of many kinds, as turned out to be actually the case. The adoption of this policy and the relatively unfriendly relations which early developed between the Board and the political authorities at Washington, again tended to limit freedom of action and to prevent the adoption of courageous and forward-looking measures as speedily and effectively as would otherwise have been the case. Closely coupled with this situation should be borne in mind the facts already mentioned with reference to the political situation, in the narrow sense of the word—the insistent demands of members of Congress for aid for their own communities, the indisposition to accept the idea of a strictly non-partisan and non-political banking system, and the more or less steady criticism of practically everything that was done or undertaken by the Board and by the banks. Eight years after too many are in the habit of thinking of the criticism of the federal reserve

system as a post-war development growing out of mistakes of policy or of war financing. The disposition to criticize and to attack was present from the very beginning, and was incident to the struggle which had been necessary in order to secure the adoption of the act itself. This criticism included such diverse elements, at times, as lack of earnings, excess of earnings, indifference to sectional necessities, overgreat regard for sectional requirements, disregard of the needs of the financial community, undue leaning upon the financial community, preference for the Germans, disposition to assist British and French finances—and in general every contradictory and unwarranted type of complaint that could suggest itself to minds whose bent was distinctly toward fault-finding rather than toward constructive achievement. The fact of being “under fire” from the first was readily apparent and the absence of any sustained or satisfactory type of support in either political party necessarily gave to the system and to its members a feeling of isolation or of being distinctly on trial which certainly did not conduce to success.

Responsibility for Conditions

It would be unjust to assign any sole responsibility for these conditions to any one man or group of men. They were the product not only of the bitterness that had attended the currency and banking struggle in Congress, but also of the anomalous condition in which the world at large, and the United States particularly, found itself. Perhaps they could not have been remedied even under the wisest and most sympathetic management. All that could be done was to make the best of the situation and to proceed as rapidly as circumstances would permit. That this course on the whole had been pursued by those who were charged with the administration of the system, will probably be the final verdict of the student of the history of the undertaking. In reading this verdict, however, it is not possible to ignore the various faults of conception and

execution to which reference has already been made, nor should they be slurred over. Every step in the process of organizing and setting on foot the reserve system has been of the utmost significance from the largest financial standpoint, and affords a wealth of inferences and instruction directly bearing upon future policies. These steps should be considered in this light, and the analysis which has been made of the conditions under which the system was set on foot is therefore made frankly and without reservation, not for the purpose of fault-finding but for that of enlarging and advancing the understanding of the situation. The fact that in these circumstances the system did steadily progress toward complete organization and that it was ready when the time came for it to feel the intense strain of the war, is in many ways an ample vindication of what was done during an extremely trying period. This in no way diminishes the importance of a true recognition of the various steps that were taken, and greatly accentuates the complexity of the problem of banking organization as it was presented at the close of 1914.

Treasury's Problems a Large Factor

Possibly the point at which the development of the system in its early stages had proven most disappointing, as well as that at which predictions were to prove least reliable, was to be found in relation to the Treasury Department. That Department had necessarily played a large part in the organization of the system. The Federal Reserve Act had assigned important duties to the Treasury in connection with the mere task of readjustment and development of the districting. It had assigned still more important functions in connection with the actual opening of the new banks, the transfer of reserves, and other similar matters. Was there any reason to suppose that this relationship would prove difficult? The early problems of organization had doubtless afforded some ground for thinking so. Not only had the Treasury proven dictatorial,

but the Board had found the relationship irksome and unpleasant in a variety of different ways. In these circumstances it would undoubtedly have been well had the membership adopted some decisive course of action, either insisting upon a separation from the Department and a more clear-cut definition of powers, or coming in some other way to a trial of strength which would have made the issue clear. But this the membership was not willing to do—perhaps had not the courage to undertake. So that the relationship with the government was allowed to become clouded, while bad precedents were established and trouble was laid up for future years. All this meant later difficulty and existing unpleasantness, with continuous difference of opinion with the Board on the one hand and the Secretary of the Treasury and the Comptroller of the Currency on the other. While it is perfectly easy to understand the reasons which prevented the clarification of these conditions in the first place, that is very far from accounting for the situation or from defending it. Equal or greater responsibility, of course, rested upon the Treasury Department. Whether the blame, if such it can be called, be assigned chiefly to one or to the other, or to both jointly, the fact remains that the development of anomalous conditions of the sort referred to was a serious reflection upon the early history of the system and the type of management which was employed in actually starting it.

Failure to Foresee Later Relationship

As a part of the same general situation must be mentioned the failure to foresee the later relationship probably to exist between the Department and the Board in future years. It would seem probable that at the outset the Department authorities were merely bent upon preventing the Board so far as possible from acquiring any definite authority, while the Board on the other hand was simply desirous of retaining as much authority as it safely could. Neither looked sufficiently

far ahead to understand what the outcome of this kind of unsettlement was likely to be. The fact that the war was in progress and that eventually there was at least a possibility of American participation, must from time to time have been present to the minds of every member of the group but was ignored by all in the absorption of routine work and the process of playing the daily game of politics. Thus there was no distinct provision against the future, no building up of strong financial machinery which should be used in the event of the difficulty already threatening and eventually unavoidable. The working out of the details of war finance came in due time as an instant necessity, and, owing to the sound substructure which had been furnished by the law itself and the organization under it, did not prove excessively burdensome nor offer any insuperable obstacles. This, however, was a situation which could not have been reckoned upon with any degree of safety, and certainly ought not to have been. Inability or indisposition to look ahead and provide for the future through the working out of proper fiscal and deposit relationships must, therefore, be esteemed an important element of failure in the organization. It ensured hasty work at a later date and more or less imperfection in such work.

An Obscure Element of Trouble

With these obvious elements of difficulty whose possibilities could not be ignored, must be combined a more obscure element dating back to the drafting of the law. It has been seen in the foregoing chapters that so-called agricultural influences had been dissatisfied with the provision for farm credit (of the short-term sort) provided by the Federal Reserve Act, notwithstanding that the terms of the law had lengthened the permitted maturity of paper in very substantial measure by doubling them in favor of the farmer. But this, it was felt by agricultural interests, was not enough, and they had therefore prevailed upon Congress to appoint a joint

committee of the House and Senate whose duty it would be to draft a suitable rural credits measure. This work had been performed during the spring and early summer of 1914, and the results of it had been laid before Congress and furnished to the Treasury at that time. By a joint understanding on the part of the political leaders of Congress and of the administration, this rural credits measure had been pigeonholed, no action having been taken regarding it. The Federal Reserve Board, when it came into office, paid no special attention to the rural credits question and there was no particular reason why it should. The rural credits measure was allowed to sleep until 1916, when it was put through Congress as a pre-campaign policy and in a comparatively limited form. There was no one either in Congress or in the administration, much less in the Federal Reserve Board, who was particularly sympathetic with the rural credits idea, or able to foresee the important bearing it would ultimately have upon the working of the system. Let it be repeated that failure in this regard was in no respect a failure of the Reserve Board or of the reserve system. It was, however, an important failure in the general situation that no one had thought it worth while to guard against trouble of the kind which past experience had shown to be most threatening in its effect upon a central banking system. For this the reserve system was to pay heavily in the future.

Some Conclusions

The reasonable conclusions to be drawn from this survey doubtless are that, while the Reserve Act itself had suffered to some extent in the process of districting and still further in the other details of organization, the instructions conveyed by it as to the creation of the new banking system had been carried out in a tolerably effective manner. The main source of trouble lay in the composition of the Board, which on the whole was unsympathetic with the purposes of the new institu-

tion Secondly, there was hazard in the attitude of the Treasury and of government officers who regarded the new system as dangerous to their ambitions for uncontrolled power In the same class of risk must be put the selection of a personnel in the several reserve banks which was in various cases distinctly hostile to the whole undertaking In the background lay lack of presidential support, elements of friction involving the Treasury and the Board, and general lack of foresight covering the great problems which had to be faced Underlying the structure of the system as set up was the element of weakness due to failure to deal appropriately with the question of rural credits.

BOOK III

THE FEDERAL RESERVE SYSTEM
IN OPERATION

CHAPTER XXXIX

THE PROBLEMS OF THE NEW SYSTEM

Organization and Operation

The completion of the process of organization and the installation of the various elements in the mechanism of the federal reserve system had, as already seen, not been simultaneously effected. The gold settlement arrangements had been deferred into 1915, the process of changing the boundaries of reserve districts had necessarily been carried on from time to time as conditions permitted and as the convenience of bankers suffered them to appear in Washington for hearing, the arrangements with state banks relating to membership had taken time and had, as already noted, been more or less steadily revised from month to month. It is not, therefore, possible to fix any exact date as representing the completion of the organization of the federal reserve system. The organization process in the reserve banks themselves was steadily going forward and changes in it have hardly ceased even at the present date. So great a system, involving such immense operations, could not be completed at any given time, but was to work out its own salvation as the result of its experience. So, when references are made to the end of the organization period, the language used has only a very general significance.

The Beginning of Operation

Nevertheless, it may yet be possible to assign a more or less concrete meaning to the term "operation" of reserve banks, and to regard a new period in the history of the un-

dertaking as opening from the moment when transactions were really begun at any reserve bank. With this distinction in mind, it is fair to regard the system, therefore, as practically starting upon its work of operation in December, 1914. Transactions during 1914 were, of course, negligible. Even had there been some substantial demand for the aid of the reserve banks, it may be questioned how far the institutions would have been in position to supply it during the first month or two after they had formally embarked upon their business career. On the other hand, it is probably true that, had there been an urgent or insistent call for reserve bank accommodation, the mechanism might have been put into active operating condition considerably sooner. The slowness with which the banks actually came into their full activity must, therefore, be regarded as being primarily a reflection of lack of demand on the part of the public. This lack of demand, as we shall see, was the outgrowth of the fact that the Reserve Act had set free so great a quantity of lending power through its change in the reserve requirements that the member banks were themselves able to provide for practically all necessary accommodations. So, when the system had become fully developed in outline at least, it appeared that there was comparatively little work for it to perform save that of studying the situation, acquainting itself with the new duties to be undertaken, and getting into touch with actual and prospective members. Perhaps it might be said that the first concrete duty undertaken by the system was that of retiring the outstanding emergency currency issued under the amended Aldrich-Vreeland Law. This, however, was a piece of work which was practically automatic, being supervised, moreover, by the Comptroller of the Currency under whose auspices the issues had taken place, so that the task of reserve banks in this connection was no more than that of providing such accommodation as was necessary to enable banks which wished to call in their emergency currency, to do so without sacrifice.

Initial Work of the Board

This period of inactivity or "breathing space," enjoyed by the banks, was by no means open to the Federal Reserve Board. The Board recognized from the beginning that not until it had completely brought into effect all of the working parts of the act could it expect the reserve banks themselves to function as they should. The Board, therefore, had no sooner completed its task of organization and had appointed the necessary directors and other officers, than it turned its attention directly to the duty of supervising plans and preparing regulations which should govern the work of reserve banks. In this beginning of its operating duties the Board recognized certain distinct tasks or duties which must be performed. Prominent among these was the development of regulations relating to the discount of paper and the marking out of the limits that should be observed by federal reserve banks in furnishing accommodation to their members. Of less importance perhaps, but nevertheless urgent, was seen to be the task of introducing a clearing system in the several districts and of making this system as extensively effective as possible, thereby providing for the regular clearance of checks and the collection of items as they came through the various institutions. Incident to the general problem of discounting and meeting the requirements of members was, of course, the formulation of plans whereby the issue of notes might take place regularly and without friction so that a steady supply of flexible currency would be readily furnished to applying banks. Still another function was obviously the organization of a complete staff of examiners who should visit the reserve banks regularly, since, from the very beginning and even before discounting had occurred, it was obviously necessary that there should be constant and official report upon the cash and other asset items held by the reserve banks. From the beginning, too, the Board conceived it to be its duty to study the Reserve Act with a view to recommending

to Congress changes in its terms, since, as one member of the Board expressed it, "without this our duties here would be of little interest or importance" The Board, in other words, practically conceived of itself as having in its hands only a routine and imperfect instrument, passed as an experimental matter and consequently requiring improvement and modification before it could be said to be available for permanent use

All of these lines of activity, coupled with necessary incidental pieces of work which fell to the Board in connection with the installation of the complex reserve system, were found to require time Some of them could, by no stretch of imagination, be said to have been completed until the year 1916 was well advanced Others were nominally finished but with the understanding that the arrangement arrived at was only tentative, and hence must be subject to reconstruction at an early date All in all, it may be said that the period from December, 1914, to approximately July, 1916, was a period of experimentation in operation and that during that time the eventual future of the system, its probable lines of development, and its prospects of success, were constantly and entirely open to question After that date, the reserve system began to be looked upon as more or less of a fixture and its administration began to assume a more positive nature Precedents had been established and actual work begun The system, however, was destined to have only about a year of normal operation before our entry into the European war which again opened an entirely new era with its own set of problems

Order of Study

The federal reserve system has now assumed an extraordinarily complex character and many volumes might be written about activities which constituted merely an incidental part of its duties In this volume it is desired to give merely

a general survey of the principal and fundamental lines of policy that were adopted and to show the chief effects of the work which was done during the eight years succeeding 1914. In attempting this survey it seems wisest to deal in successive chapters with the principal topics to which the Board devoted its attention, and so far as possible to present them somewhat in the chronological order in which they appeared—this at least during the experimental period prior to the middle of 1916. By this method of treatment the historical course of development will be observed, while at the same time it will be practicable to treat successively the conditions that were created in the system as the outcome of the policies which were initiated and set at work as a result of the various steps looking toward complete operation.

Choice of Work

The order in which the Board undertook to follow out this task of development was not exactly logical. The question has often been asked why certain things were done in the order in which they were done, and why postponement occurred in the case of others. This question can be better answered at the end of a historical survey of the Reserve Act than at the beginning. It is a matter which can be understood only as the result of a detailed study of the work actually done by the Board and of the numerous factors which acted upon it throughout its career. Had it been possible at the beginning to lay out the duties of the system and the work to be done by the Board in logical order, it is likely that a good many things would have been carried out in a way different from that which was in fact pursued. Had the Board felt free to deal with its problems by successive logical steps, some things which it did would have been deferred until a much later date while others probably would never have been taken up at all. As it stood, the order of the Board's work was in no slight degree a matter of expedi-

ency The system had opened under conditions of utmost difficulty. Many things required to be done because of the continuance of the war. They either were or were not considered problems of such pressing moment that they could not be postponed, and hence the necessity of immediately taking them in hand either in order to supply the basis for later work or in order to satisfy the public mind that the questions referred to the organization were being given due attention.

What Might Have Been

The student of the federal reserve system will probably always wonder whether in quiet times and with the long interregnum which would naturally have been afforded by the release of reserves (lightening the pressure which would otherwise have made itself felt for immediate rediscount), the development of the reserve system might not have proceeded much more more effectively and satisfactorily. There is some ground for rendering an affirmative answer to such a question, but on the other hand, there may be doubt whether member banks would have left the Board unhampered to pursue its work as it pleased. Difficulties would have had to be met either way. As things stood, the order of business finally determined upon after the necessities of organization had been completed was about as follows: note issue, discount rates, commercial paper, bankers' acceptances, trade acceptances and other paper, gold settlement fund, state bank membership, clearances (intradistrict), general organization and examination problems, relief of supposed agricultural requirements, foreign loan and export financing, and preparation for war. This order of subjects and the work done in connection with them practically carried the Board through the opening of the war period. It should not be supposed, of course, that there was no retracing of steps. That was constantly necessary, and at the same time the problem of discount rates, which had to be dealt with in a tentative way

at the very outset, became a continuing and serious issue, affording opportunity for discussion at intervals practically throughout the years 1915 and 1916. The order thus outlined, however, represents substantially the form that was given to the development of the system from the chronological standpoint.

Stages of Development

It has often been noted that the history of the federal reserve system throughout its eventful first years consolidated into a short space of time many of the experiences which would ordinarily have occupied a generation in the former slow development of the banking system in times of peace. That is unquestionably the fact, and because it is a fact there is necessity for marking off the history of the federal reserve system into certain well-defined periods whose characteristics are quite different one from another. There are many differences of opinion as to the precise dates at which such dividing lines may be drawn, but in a general way the points of division are tolerably clear. Beginning immediately after the close of the organization period, which may be conceived of as terminating with the formal organization of the reserve banks in November, 1914, the first period of development may be regarded as having covered the year 1915 and the bulk of the following year, with the month of December, 1916, opening the second period of the system's history. As a characteristic of the first period had been primarily constructive work in completing the internal organization of the system, so the second period was occupied primarily with preparation, either direct or indirect, for war, and with the settlement of questions directly growing out of the fact that war was already at its height in Europe. This second period may be conceived of as ending with the declaration of war on April 6, 1917. The third extended from that date to the autumn of 1918, and closed with the armistice on November

II During this third period the obvious problems of the system were those of war financing. A fourth period may then be recognized as extending from November, 1918, to November, 1919, and including the post-war inflation period during which circumstances compelled an overrapid growth in the operations of reserve banks without any determined effort of an overt character to stop the expansion. During the fifth period, from November, 1919, when advances of discount rates were undertaken, to July, 1920, when reaction had been fully recognized, the months were largely occupied with a study of credit, the tightening of discount rates, and the effort to narrow the eligibility of paper which had attained too great a breadth. From July, 1920, to the autumn of 1921, the problems of so-called deflation presented themselves including questions of agricultural credit, problems of banking support, and reorganization and general readjustment. This closes the sixth period of development. The seventh period, from December, 1921, to about the end of 1922, was occupied with internal reorganization to a peace basis, and with the discussion of criticisms which had been brought to bear upon the policies undertaken by the system during the heat and haste of the war and post-war development.

Criticism of Historical Development

These seven periods of development, as already observed, must not be taken as arbitrary or as absolutely fixed. They shade into one another at times by almost imperceptible degrees, although, as already stated, there was usually some outstanding event of importance to mark the transition. The necessity of differentiating between them is found to some extent in changes which occurred in the personnel of the Board and of the system as well as of the Treasury Department, but is found in a more important way in the changes which the business and banking system of the country were undergoing. Uniform or sustained comment or criticism ap-

plying alike to all of these periods in succession is likely to give a somewhat biased and unfair view of the situation. The point of view necessarily changes to some extent from time to time

Effect of the War

From what has just been said, it is plain that the war and the changes which it introduced into the entire structure of industry, commerce, politics, and government was, in the case of the reserve banking system as in that of everything else at the time, the conditioning factor which practically settled or determined the course of development. It is a commonplace remark, therefore, to say that the war had a profound influence upon the federal reserve system. It would be more accurate to say that the federal reserve system developed as a result or function of war financing and its consequences. Indeed, in a certain way the history of the reserve system during the eight years from 1914 to 1923 is a history of war financing and of war banking. This must be taken into account in many fundamental ways for policies that were adopted and for methods that were pursued which under happier circumstances might not have been favorably considered. It must also account for the phenomenal growth of the system in assets and operations and perhaps for the development of a type of criticism in Congress which might not otherwise have made itself apparent, at least at so early a date. These things are stated in no spirit of apology. The fact that the reserve system had been definitely organized before the war had gone far, was from a financial standpoint perhaps the determining element in the whole contest, since it was the success of the United States in financing enormous war transactions that from a material standpoint eventually rendered the success of the Allies possible at the date when it was actually achieved. The war, in other words, not only disturbed the whole current of the history of the system, but

gave it a surpassing opportunity to show what it could do—an opportunity that perhaps could in no other way have been obtained. A reasonable view of the years from 1914 to 1923 must, therefore, consider the federal reserve system as having been not only distorted but also developed by the war, and the effect of the struggle upon it purely from an intra-system standpoint must be regarded as being a curious mixture of both good and bad. What would have been the course of development without this wholly unexpected and extraneous influence of unprecedented power would be little more than idle conjecture. What may be stated with some degree of assurance is that as a result of the abnormal conditions which existed during the years in question many banking problems were not only left unsolved but were given a new aspect, so that the close of the war found our banking problem in numerous phases still awaiting a final solution, notwithstanding that the enactment of the Federal Reserve Act had been heralded by many as affording at least the basis for such a solution, and as justifying the hope that many fundamental financial problems might be finally disposed of at a comparatively early date.

CHAPTER XL

FEDERAL RESERVE NOTES

Place of Note Problem

As will be recalled by those who have followed the earlier history of the banking reform movement, the development of an elastic note issue had been one of the first and most important objects sought by those who had called for legislation. Such notes had been provided for with more than usual care in the Federal Reserve Act,¹ and, in spite of all efforts on the part of politicians to obscure and mislead, the result had been to bring about an enactment which was undoubtedly capable of fulfilling the most important requirements of the demand for elastic note issue. Among the features of the federal reserve organization, therefore, which was most earnestly looked forward to was the development of an entirely new system of note issue on a large scale and free of the evils which had previously beset our currency. Naturally, therefore, the very first duty which the Federal Reserve Board felt called upon to discharge was that of selecting designs for notes, passing upon the dies and plates, and securing the printing of a moderately large quantity of the currency. The urgency of acting upon the note issue and of getting it established was the more obvious, in view of the fact that war necessities had led to the issue of more than \$370,000,000 of Aldrich-Vreeland notes. As these were retired, it was believed there would be an urgent call for federal reserve notes and the Board desired to be prepared for all possible emergencies and contingencies. So, among the very earliest undertakings of

¹ See Section 16 of act as originally passed, Appendix VI.

the Board was the discharge of the routine duties connected with circulation

Administrative Difficulties

Hardly had the Board begun its work, however, when it found that, contrary to what had been expected, there were serious administrative difficulties to be disposed of. Among these were the issuance of workable regulations which would result in the steady, prompt, and continuous transfer of notes from the Board itself to the several reserve banks. With a view to developing a satisfactory system on this subject, the Board accordingly undertook a series of discussions in which the various aspects of the subject were considered. Unfortunately in these discussions there was comparatively little disposition to allow fully and freely for the idea of an elastic note currency, while some members of the Board, particularly the Treasury representatives, were disposed to insist upon surrounding the note issue with all possible restrictions and safeguards of an administrative variety. Indeed, had their views been fully followed, the whole undertaking would doubtless have been swathed in official red tape and the note issue rendered of comparatively small value. Discussion, however, brought about a partial compromise on this subject and resulted eventually in the formulation of regulations which, although far from liberal, were certainly not as extreme as those which had at first been advocated by the Treasury and particularly by subordinate officers in the Department who in the past had been largely concerned with matters relating to the issue of national bank notes.

So important did the note issue come to be considered and so significant a part did it play in the later discussion of the federal reserve system, that it is worth while to consider with some detail the different stages through which the early problem of note issue passed, while the eventual practice was in process of evolution. The first step was evidently the analysis

of the act itself in its note issue sections and the adjustment of reserve requirements in such a way as to correspond to the provisions of law. It was found that the technique of the latter was of no small difficulty because of the provisions which had been embodied in the act for the purpose of establishing the collateral deposit with federal reserve agents and also for the purpose of insuring steady redemption.

First Regulations Developed

The first set of regulations developed by the Board for the purpose in question was as follows

REGULATIONS GOVERNING DUTIES OF THE FEDERAL RESERVE AGENTS WITH RELATION TO FEDERAL RESERVE NOTES

(1) Federal Reserve Agents shall from time to time notify the Federal Reserve Board on a standard form, Form No—— and as far in advance as practicable, of the supply of Federal reserve notes they expect to require in order to meet applications for issue, stating the amounts of the different denominations desired.

(2) The Federal Reserve Board will determine to what extent notes shall be supplied to Federal Reserve Agents and will notify them that they are authorized to issue notes so supplied from time to time to their respective banks in response to applications duly approved by said agents.

(3) The Federal Reserve Agent shall from time to time notify his Federal Reserve Bank of the extent to which he is authorized to meet its applications for Federal reserve notes.

(4) A Federal Reserve Bank desiring an issue of Federal reserve notes shall make application therefor to its Federal Reserve Agent furnishing at the same time to said Agent a list of the collateral which it proposes to tender as a deposit against said notes, said application to be made out on Form B D 21-1.

(5) The Federal Reserve Agent shall carefully examine the collateral and make such investigation as he may deem necessary. If satisfied that the collateral conforms to provisions of Section 13 of the Federal Reserve Act and the Regulations of the Federal Reserve Board made pursuant thereto, he shall so inform the Federal Reserve Bank and shall notify said bank that Federal reserve notes will be issued as soon as the collateral is deposited and the requisite gold redemption

fund paid to the Treasurer of the United States, and the required gold reserves set apart by said bank *

(6) On receipt of said collateral and a certificate from the Treasurer of the United States setting forth that the Federal Reserve Bank has deposited with him the requisite gold redemption fund, the Federal Reserve Agent if satisfied that the bank has the gold reserve in its vault required by law to be held against its notes, shall issue, to extent that such issue has been authorized by the Federal Reserve Board, Federal reserve notes to said bank receipting for said collateral on Form B D 21-2, reporting to the Federal Reserve Board each day all notes issued to and withdrawn by said bank, using for that purpose Form F R A 5, and notifying said Board of the collateral accepted, using for that purpose Form B D 21-3

(7) If at any time the Federal Reserve Agent deems it necessary to require changes in either the character or amount of collateral deposited to protect said notes, he shall notify the Federal Reserve Board and at the same time call upon the Federal Reserve Bank for additional collateral or new collateral to be substituted for that which in his opinion or in the opinion of the Federal Reserve Board is unsatisfactory, using for that purpose the Forms already referred to

(8) If at any time the gold reserve required by law to be held by a Federal Reserve Bank against Federal reserve notes issued to it falls below 40% (including therein the gold fund required to be maintained in the Treasury) the Federal Reserve Agent shall at once notify the Federal Reserve Board

(9) The Federal Reserve Board will, upon receipt of notice provided in Paragraph 8 hereof, establish a graduated tax as provided in Section 11 of the Federal Reserve Act upon such deficiency, which tax shall be computed and collected by the Federal Reserve Agent and forwarded to the Federal Reserve Board. Said tax shall be computed as follows

When reserves fall below 40% but are in excess of 32½%, the tax upon the deficiency shall be at the rate of 1% per annum,

When reserves fall below 32½% but are in excess of 30%, the tax on the entire deficiency below 40% shall be at the rate of 2½% per annum,

When reserves fall below 30% but exceed 27½% the tax upon the entire deficiency below 40% shall be at the rate of 4% per annum,

and so on, increasing at the rate of 1½% with each reduction in reserve amounting to 2½% or any fraction thereof

* Note Under Section 16 of the Federal Reserve Act, this redemption fund may be increased above the 5 per cent legal minimum at the discretion of the Secretary of the Treasury

Gold Reserves against Fed'l Reserve Notes	Penalty Tax on Deficiency in Reserves (Legal minimum including Redemption Fund)
40%	
37½	1%
35	1
32½	1
30	2½
27½	4
25	5½
22½	7
20	8½
17½	10
15	11½
12½	13
10	14½
7½	16
5	17½
2½	19
0	20½

(10) The Federal Reserve Agent shall receive Federal reserve notes unfit for circulation presented by the reserve bank or any member bank or transmitted to him by the Treasurer of the United States, and shall forward the same immediately to the Comptroller of the Currency for cancellation and destruction using Forms F R A 1-5. The Comptroller will transmit new notes in lieu thereof to the Federal Reserve Agent, at the same time notifying the Federal Reserve Board of such action. (See also Paragraphs 16-17-18)

(11) The Comptroller will cancel and destroy such notes unfit for circulation in the manner provided in the National Bank Act for the cancellation and destruction of National bank notes unfit for circulation.

(12) The Federal Reserve Board will maintain a record of the amounts of notes of the several denominations supplied to each Federal Reserve Agent, of the amounts issued through said agent to his Reserve Bank, and of the amounts in the possession of said agent.

(13) On the receipt of notice from the Federal Reserve Board that a rate of interest has been established to be charged upon issues of Federal reserve notes, the Federal Reserve Agent shall notify his bank and shall compute and collect the amount of interest due from said bank and forward the same to the Reserve Board.

(14) When Federal reserve notes issued by the Federal Reserve Agent to a Federal Reserve Bank are deposited by said bank for the purpose of reducing its liability for outstanding circulation, the Federal Reserve Agent shall return to said bank a proportionate amount of

the collateral deposited by it against its notes, using for this purpose Form B D 28-1

(15) The Federal Reserve Agent shall notify the Federal Reserve Board of any deposits made with him by a Federal Reserve Bank of its own Federal reserve notes, or of gold, gold certificates or lawful money, for the purpose of reducing its liability against its outstanding notes, using for that purpose Form F R A 5

(16) The Federal Reserve Agent shall hold such notes, gold, gold certificates or lawful money so deposited, subject to the order of the Federal Reserve Board. Any gold or gold certificates deposited with a Federal Reserve Agent may be deposited in the nearest sub-treasury of the United States, (with the consent of the Secretary of the Treasury) and order gold certificates issued thereon payable to the Federal Reserve Agent

(17) On deposit of such notes, gold, gold certificates or lawful money, a proportionate amount of the collateral may be returned to said bank, the transaction to be reported at once to the Federal Reserve Board, using for that purpose Form F. R. A. 5

(18) When Federal reserve notes are deposited by a Reserve Bank with the Federal Reserve Agent, said agent shall return to said bank the collateral and any gold, gold certificates or lawful money deposited by it to reduce liability except so much of said gold as may have been required by the Federal Reserve Board to transmit to the Treasury for redemption purposes, upon request of the Secretary of the Treasury

(19) On receipt of notice from a Federal Reserve Agent that certain of its notes have been returned, the Federal Reserve Board will request the Secretary of the Treasury to direct the Treasurer of the United States to return to said bank such portion of its redemption fund as may exceed the minimum requirement of that fund against the notes still outstanding

(20) When a Federal Reserve Bank shall ask to withdraw collateral and substitute therefor other collateral against Federal reserve notes, the Federal Reserve Agent shall examine said offered collateral and pass upon it in exactly the same way as if it were collateral for original issue of Federal reserve notes. If approving the collateral, he may make the exchange, reporting the fact at once to the Federal Reserve Board, using Form B D 28-3

(21) When Federal reserve notes have been returned by the Reserve Bank to which issued, and the collateral and other security return to the bank, said notes shall be held by the Federal Reserve

Agent and shall be reissued only on the same terms as an original issue, and with the use of the same forms All notes so returned by Reserve Banks shall be reported at once to the Federal Reserve Board

Subsequent development did not greatly change the purpose or general tenor of the regulations, but gave results in adapting them rather more closely to bank requirements so that there was a relative simplification of machinery and a rather more prompt means of obtaining the notes when needed In the eventual form in which issued the regulations assumed a shape not very different from the first proposal

Salient Points

Analysis of these regulations will show that the salient points which were dealt with—apart from the questions of reserve which at the time were entirely for the future to determine, since there was no immediate prospect of the reserves being reduced to anything approaching the legal limit—were these

- 1 The definite insistence that before notes were issued there should be in the hands of the federal reserve agent a block of collateral representing actual rediscounts on the strength of which the notes called for should be furnished
2. Arrangements between the reserve agent and the Treasury Department providing for the depositing of the necessary gold redemption fund and the routine release of the notes that were required with their shipment to the reserve bank •
- 3 Various provisions for the retirement of unfit notes and for the presentation of fit notes of other banks for redemption

Of these elements in the note issue process there was only one which for the immediate present need be regarded as giving rise to real difficulty Practically all of the requirements were distasteful to the member banks and apparently to the federal

reserve banks It is perhaps well to say at this point that there has never been a time, since the adoption of the Federal Reserve Act, when there was not more or less agitation going on with a view to the modification of the note issue provision. Member banks have at all times desired to see it liberalized and the issue of notes made easier, they have always desired greater liberty for use of notes in reserve and less stringency as to the presentation of the notes for redemption. On the latter point reserve banks have periodically set on foot investigations and in some cases made recommendations. As to these matters more may be said at a later point.

Question of Collateral

The initial difficulty was not found in matters of technique or detail, but was centered largely around the fact that reserve notes could not be issued except in exchange for collateral. It was puzzling to member bankers to know why they could not take gold or legal tender notes to a reserve bank, turn them in, and receive in exchange an equal amount of federal currency fresh and clean for distribution to their customers. This they regarded as the essential service of a reserve bank, and when it was pointed out to them that the currency was intended to be "elastic," that is, corresponding to the needs of business and not issued except when a new volume of transactions required it, they were impatient and restive, regarding this as an academic plan possessing no merit. Strangely enough, objections of this sort were lodged by some of those very bankers who in years past had had most to say about an elastic currency. The reserve banks felt this criticism sharply and accordingly were inclined to try to find some way to relieve it. They had not been open more than a very few weeks before what was practically a generally accepted expedient was hit upon, talked over at meetings of the council of governors, and finally put into general practice. It was called "reversing the pump."

Neutralizing the Act

The operation of the plan was as follows. A customer bank having discounted some commercial paper with a reserve bank to the amount of, say, \$10,000, the reserve bank was then in position to issue \$10,000 in notes in exchange for this paper as collateral. The collateral would be turned over to the agent, who would thereupon issue the notes after going through the necessary formalities for the purpose of getting them from the Board. As things then stood, the reserve bank had parted with \$10,000 of collateral which was in the hands of the agent, while the Board had "issued" \$10,000 to the agent who had transferred it to the bank. The bank set up a reserve of 40 per cent against the notes. Then, in the event that a new customer came to the reserve bank and asked for federal reserve notes, there would be no means by which the reserve bank was able to get notes from the agent, since presumably its collateral was entirely in the hands of the agent. It, however, now resorted to the plan of redeeming its collateral by placing gold to an equal amount with the agent. The effect of this, then, was to release the reserve previously set up against the notes. The agent now had \$10,000 in gold, while the bank had taken back its collateral. The collateral would in this way be presented over and over again, being returned to the bank after each operation just as if it were a new offer of commercial paper. The result was that the bank was able to "pump" out as many notes as it wished, so long as it had a single dollar of commercial paper of eligible variety, provided, however, that the agent went through the more or less elaborate routine that was necessary in getting the notes.

This practice speedily spread throughout the system and was fully known to the Federal Reserve Board, whose members appeared to have but little sympathy with the idea of elastic currency. In fact, as one member of the Board remarked, they felt that it was "useless to deal in academic refinements on the subject of notes. Anything that looked

like money, smelt like money, and felt like money, was money, and it could be issued in any quantity—provided, of course, that the issuer were well protected”—and how could he be better protected than through the deposit of gold or legal tender notes in an equal amount? In this view of the situation there was no reason why the notes should not be issued in as great volume as was desired. The objections of the Treasury officials to easy note issue had had no theoretic basis but were founded entirely upon considerations of security and protection. With these satisfied they had no hesitation in going as far with the issue of notes as they might be requested to do.

The Holding of Gold

Indeed, the only real difficulty or opposition that manifested itself to this perversion of the original terms of the Reserve Act was found in the purely mechanical difficulties, which were connected with the holding of gold. The gold settlement fund, however, as elsewhere seen, was established by the Board in the spring of 1915, and not only fulfilled its purpose as a means of exchange and settlement, but was also speedily appreciated in a new light—that of acting as a means of conserving or protecting the gold of the banks. Not a few of the federal reserve banks gradually deposited most of their gold in the gold settlement fund. But when the process of “reversing the pump” made it desirable for them to transfer considerable quantities of gold to the reserve agent, that official apparently had no means of protecting his gold. True, as the various banks developed vault space, there was set apart for the use of the reserve agent a due proportion of such space and he was able to pack his gold away within that space. As time went on, the space became less and less adequate and the reserve agent more and more fearful lest the constant ebb and flow of gold might, through some error or perhaps dishonesty, result in leaving him “short.” Hence the demand for the

establishment of a section of the gold settlement fund which should be known as the "federal reserve agent's fund," through which should be permitted all those transactions between reserve agents which grew largely out of the transfer and redemption of notes, the cancellation of currency, and incidentally the hoarding and safekeeping of the gold behind them. Such a section was duly established by the Board late in 1915 and quite effectually served its purpose. The gold, both that belonging to the banks and that belonging to the reserve agents, was held in sub-treasuries where its safekeeping was about as perfect as would be possible under any circumstances. The transfers growing out of redemption and the like operations were handled through the gold settlement fund and the reserve agent's fund, while the member banks were practically given *carte blanche* to apply for and obtain as many notes as they chose, always provided that they could furnish legal tender currency to protect them.

The working of the note issue section had thus, even within a few months, drifted very far away from its original intent and had done so in large measure because of the lack of sympathy of the system and of the Board itself with the general idea of elastic business currency. It has often been asked whether the Board in these early days devoted much attention to the study of questions of practice or to the analysis of the effect of additional note issues, or to other matters of the same sort. To all such inquiries a flat negative must be returned. None of these questions had received any considerable degree of study or discussion during the first two years. The Federal Reserve Act with its provisions as to note issue, its subordinate organization of taxation, its authorization of the Board to withhold or issue notes as that body saw fit, and its carefully worked out mechanism of redemption, was regarded as little more than a piece of hampering machinery which tended to restrict the convenience of the community,

and which, if it could legally be kept idle, should very properly be treated in that way

Growth of the Note Issue

In these circumstances it was perhaps strange that a larger amount of note issue did not occur. The truth was that the country was already very well provided with circulating medium. It was a long time before all of the Aldrich-Vreeland currency was called in, and by the time that it had practically all been retired the gold movement from Europe had begun, reversing the outward movement which had been characteristic of the early weeks of the war. Gold poured steadily into the United States and found its way at once into the bank vaults. Some of it was placed in the Treasury and gold certificates were issued against it. There was no very special inducement to increase the issue of federal reserve notes except for the purpose of obtaining fresh clean currency, and in the case of city banks of facilitating their convenience in making payments to depositors. Such convenience, of course, would have been greatly furthered by an issue of federal reserve notes going down to the lowest denominations—\$5, \$2, and \$1—and it soon became apparent that the banks would have gladly seen the notes issued even in these low denominations, but as yet they were not prepared to make such request and to back it up with pressure. Accordingly, during the first two years of the history of the system the note issue continued, technically governed by the original provisions of the law, but practically managed upon the modified basis already outlined.

The following brief tabulation will show at a glance the general movement of notes during the months in question. At the highest point federal reserve notes, prior to the end of 1916, probably never constituted more than about 15 per cent of the total paper currency then in circulation.

FEDERAL RESERVE NOTES ISSUED BY FEDERAL
RESERVE BANKS AND IN CIRCULATION
ON DATE NAMED

January 28, 1916	\$179,224,000
February 25	171,368,000
March 31	163,066,000
April 28	163,094,000
May 26	159,389,000
June 30	152,244,000
July 28	152,590,000
August 25	156,345,000
September 29	196,538,000
October 27	214,622,000
November 24	240,448,000
December 29	275,353,000

Reserve Notes in Reserves

It would be difficult to say exactly how far the federal reserve notes actually went into bank reserves from the early days of their issue. To some extent, however, this was undoubtedly the case. True, their use as reserves in the vaults of national banks was forbidden by law, while of course reserve banks could not carry them. There were many state banks, however, which for years past had made a practice of carrying national bank notes in their reserves without opposition or hindrance from the state banking commissioners of the several states. Reserve notes were as good as national bank notes and there was no evident reason why they should not be given the same status as the latter. Thus they undoubtedly attained, while on the other hand the public at large was not disposed to discriminate between them and the national bank notes or government notes which they closely resembled. When the notes were first issued they were viewed for a day or two with curiosity and there was languid comment in the newspapers upon the appearance. They then speedily settled back into the same rôle as had been played by national notes, and they neither showed any very great activity of redemption nor in the public attitude toward them was there in any other way, so far as could be perceived, special danger or special advantage. They might about as well have been simply an

addition of equal amount of national bank currency, though of course it should be remembered that such an addition would have been difficult because of the limitation of the amount of government bonds outstanding and available as a basis for circulation

Unsatisfactory Note Situation

To all intents and purposes, then, during the first year or two of the federal reserve system the note issue was largely a merely mechanical matter of convenience involving no important theoretic issues. It was either the equivalent of a gold or specie certificate, or in smaller measure, the representative of collateral (commercial paper) indorsed by member banks and in the hands of reserve banks. But for reasons already stated, it had no material relationship to the business of the country, did not constitute a measure of such business, was comparatively limited in amount, and had rather successfully evaded the various provisions of the Federal Reserve Act which were designed to ensure prompt eligibility and elasticity. The question what would have been the future of the federal reserve note had there been no subsequent developments, like those which grew out of the war, to necessitate a larger issue of the notes, may very well be raised. Conjecturally, such a question can be answered only with the statement that, so far as indications go, the federal reserve notes would probably have occupied somewhat the same position as national bank notes, and that while they would doubtless have gradually expanded as the national bank notes were retired, there was but little in the experience of the time to show that they were really called for in large measure by the interests of the business community or that they would have expanded very materially unless a vacuum was created for them. This opinion is strengthened by reason of the fact that so large a current of gold was flowing into the United States from European countries

The situation as it developed in the minds of the Board

members was very well outlined at the end of two years of operation in the following letter, written by a member of the Board

November 27, 1916

To the Federal Reserve Board,
Washington
Gentlemen

On May 10, 1916, I prepared for the Board a short statement dealing with Governor Hamlin's brief on the subject of note issue amendments. I took the position at that time that there were three amendments to the Federal Reserve Act relating to this matter which were very desirable

- (1) The right to issue Federal Reserve notes directly for gold,
- (2) A consolidation or combination of the accounts of the Federal Reserve Agents and the Federal Reserve Banks so that we would have the responsibility of the Banks behind the custody of the notes, and not only that of the Federal Reserve Agent, so as to provide that the Reserve Banks shall show all notes outstanding in the hands of the public as a liability and all assets held against them as an asset of the Bank,
- (3) An amendment to Section 14, of the Federal Reserve Act which would liberalize the law in respect to collateral behind Federal Reserve notes by making eligible as collateral bankers' acceptances, or what is known as "bought paper," as well as commercial paper rediscounted for member banks

I then took the position that if these three amendments were secured it would be neither necessary nor desirable to ask Congress to make Federal Reserve notes legal reserve

Since that memorandum was written the third of the above mentioned amendments has been passed by Congress and another amendment has also been passed which has a very important bearing on the situation, to wit the authority to member banks to keep any part of their reserve with the Federal Reserve Bank, instead of in their own vaults. I still believe that the amendments suggested by me on May 10th are very desirable and that if they were passed it would not be necessary, at least at this time, to make Federal Reserve notes available as bank reserves. However, the proposal, so ably urged by my colleague, Mr. Warburg, is entitled to the most careful consideration, first, as to the desirability of the object sought, and, second, as to whether there is any better means of attaining it.

First, as to the object sought. It appears to be Mr. Warburg's desire to impound in the Federal Reserve Banks a very large share of

the country's gold supply, whereas I rather question the desirability of going too far in that direction. My feeling is that under the changes in the law which I have suggested, we would have little difficulty in accumulating in the Federal Reserve Banks half of the gold stock of the country not in the hands of the Federal Government. If the other half were in the hands of the public and in those of member and non-member banks it would be where it could serve an important purpose as a sort of secondary reserve supply which would be called upon in case of great need. If our banking system was under a strong central management, and the form of our Government was like that of the German Empire, I can readily see where it would be natural and perhaps desirable to act on Mr. Warburg's suggestion, but, considering the form of our Government, the temperament of our people, and the dangers of over-expansion and over-speculation, I think we should not put all of our golden eggs in one basket.

We all recall that the panic of 1907 came as a climax to several years of great expansion in expenditures in all kinds of business enterprises, a period of ten or eleven years of pyramiding upwards almost without interruption. Six months before the panic came many wise men thought that things looked "squally," and yet the temptation to keep on stretching bank resources to the limit was too strong even for them to resist. For this and other reasons I can not help feeling that there is danger in putting all the elasticity in the Federal Reserve Banks and not leaving a reserve of elasticity in the banks of the country. Of course, I am aware it is somewhat inconsistent to say that a balance with the Reserve Bank shall be counted as a reserve, whereas, the notes of the Bank can not be so counted. I am also aware of the fact that as time goes on bank balances are going to play a greater part than Federal Reserve notes, that when our check clearing and collection plan is fully developed, member banks will care less about drawing out Federal Reserve notes, and more about transferring balances by drafts and checks. On the other hand, the use of Federal Reserve notes will be always greatest in the parts of the country where there is the greatest necessity for caution, in those parts of the country where other credit instruments play a smaller part and where actual currency plays a larger part.

I can see that if we do not make Federal Reserve notes reserve and if we permit, say one-half of the gold holdings of the country to remain in the hands of member and non-member banks, we may sometimes reach a point where a Federal Reserve Bank has exhausted its unpledged gold supply and can not issue any more notes. Member banks,

coming to their Federal Reserve Bank to borrow will, in such a case, complain that "the well has run dry," but when that time comes the Federal Reserve Bank will say to those member banks, "If you have gold in your reserves and will deposit it with us we can help you, because we can immediately expand that gold in the ratio of 1 625 to 1, and we can hold your gold to count as reserve and still help you with currency or book credits"

I agree entirely with Mr Warburg's argument that we should put ourselves in a position to release gold freely when the European war is over For us, as a nation to have accumulated through a favorable trade balance an enormous fund of gold and then attempt to put the bars up and so prevent the world's supply of gold from seeking its natural level would be absurd and even monstrous Such action on our part might very properly lead to a demonetization of gold, but I can not conceive that gold will go out of the country except in four ways, *first*, by a reversal in the balance trade, *second*, by the spending of money in Europe by Americans, *third*, by remittances to Europeans by Americans and immigrants, *fourth*, by loans to Europe

There are some other general reasons against making Federal Reserve notes reserve which might also be mentioned It is bad education for the public to let it imagine that a note of a bank is reserve because Congress says it is reserve The fundamental reliance of our whole structure is the gold, or metallic basis behind our currency While it is true that the Government guarantees the notes, every one of us will take the position that the notes must be secured, without leaning upon the Government and without even suggesting that the Government shall ever be called upon to make them good The Government supervises their issue, must be satisfied that the security and the reserve behind them is ample and sufficient, but it was never seriously meant that the Government was going to tax the people to pay these notes

Viewed from this aspect, it isn't good economics for Congress to say that "greenbacks," or any other kind of notes that are not based on the deposit of 100% of gold can be called the ultimate reserve of member banks The fact that we have taken some wrong steps in this direction in the past does not at all justify our doing it again The greenback is simply the promise of the Government with a gold security of approximately 35%, the national bank note besides being the obligation of the issuing bank is security of the Government, as attested by the deposit of the United States bonds and has a gold reserve of only 5%. The Federal Reserve note has 100% of com-

mercial paper as collateral, and 40% or more of gold reserve behind it, besides which it has the guarantee of the Federal Reserve Banks, the member banks, and the Government. No one of these three kinds of currency can properly be considered ultimate reserves, and they are unquestionably good and ought to be in every sense legal tender. It appears inconceivable that they should not be absolutely good at all times and readily acceptable by the people in all sorts of transactions as a substitute for actual specie. When it comes to international transactions, gold, or its equivalent only, can be used, but in all intra-national transactions there is no reason why these various representatives of money should not perform all the functions, except those of being ultimate reserves. The fact that state banks are permitted to use national bank notes and reserve notes as reserves and actually do so, only accentuates the necessity of keeping the ultimate reserves inviolable.

The object which Mr. Warburg seeks to attain—of securing a much larger share of the ultimate reserves of the country in the hands of the Federal Reserve Banks—might be attained in another and possibly less dangerous way if the Federal Reserve Act were so amended as to state only those reserves which member banks must carry with their Federal Reserve Bank, stating in so many words that the specie and currency which any bank shall carry in its own vault, or till, will be left to its own judgment. The ultimate reserves, in other words, will be with the Federal Reserve Bank. The advantage of this method to the member bank would be that the many kinds of currency in its possession, as well as specie, would serve its purpose equally well—gold or silver certificates, greenbacks, national bank note currency, Federal Reserve notes, or Federal Reserve Bank notes. What the reserves should be is necessarily a matter of study and calculation, but suppose, for example, we should start out with the proposal that country bank reserves held with the Federal Reserve Bank should be 8%, the member banks in reserve cities should hold 12%, and the member banks in central reserve cities should hold 15%. In this connection it is proper to mention that under the laws of a number of states the required cash reserves is left entirely in the judgment of the banker, and in European countries it is the custom to let bankers use their own discretion as to the cash reserves they shall hold. While it is not suggested that this discretion apply to the entire reserves it is thought that it can be safely applied to the bank's own counter cash and vault requirements.

This may not be the best solution of the problem, yet it is at least

worthy of consideration. If, on the other hand, Mr. Warburg's plan is adopted, he, himself, admits that it would be desirable to keep, not 40% of gold behind Federal Reserve notes, but 60% or 70%. Indeed, it is probable that it would be necessary to change the law in regard to ultimate of gold reserve behind Federal Reserve notes and to raise the limit below which a penalty, or tax, shall apply to, say 50%.

There are other ways in which, without any congressional action, much might be accomplished to put the gold of the country in the hands of the Federal Reserve Banks and member banks, rather than by leaving it where it will be hoarded by people, or used for everyday currency, that is, by readjusting the denominations of gold and silver certificates and other forms of currency. As it has been pointed out several times, if gold certificates were not printed in denominations less than \$50, gold certificates would rarely appear as currency, and become, as they should be, almost exclusively reserve money.

From the above, it will appear that, while I am not favorable to the plan of making Federal Reserve notes reserve, I am not opposed to a limited extent, at least to the object Mr. Warburg has in view, to wit the greater concentration of gold in Reserve Banks.

Respectfully submitted,

Redemption of Bonds

It seems best at this point to make brief reference to the more or less complex provision which had been introduced into the Reserve Act as a result of compromise and which had intended to provide for the gradual retirement of national bank notes then outstanding. It will be recalled that the provision in question, carried in section 18, was equivalent to an authorization to the Board to receive offerings from holders of circulation bonds each year in an amount not more than \$25,000,000, and then to distribute this sum among reserve banks. These banks then had the option of converting the 2 per cent bonds which they thus received, into 3 per cent without the circulation privilege. The effect would have been to retire \$25,000,000 of national bank notes each year or to place in the Treasury a sum equal to that amount in other forms of money. Assuming that there were outstanding at the time about \$725,000,000 of national bank notes, the

period required to dispose of the national bank notes entirely would thus have been about 29 or 30 years. At the end of that time it might have been expected that the bond-secured currency which had so long been an object of criticism and attack would have disappeared, and that its place would have been taken by federal reserve notes—always assuming, of course, that commercial paper received by the reserve banks was sufficient (as intended by the original act) to furnish a basis for the new notes. If such paper proved insufficient the act nevertheless provided a way of meeting the difficulty, by authorizing the reserve banks to apply for and obtain "federal reserve bank notes" which could be issued on the same basis as the national bank notes, i. e., with protection furnished by the government bonds which they had taken over from the owners (the national banks). This provision was also intended to enable banks which feared loss on their bonds to protect themselves by turning over the bonds to reserve banks which thus would make a certain market for them.

The Reserve Board, soon after its organization, undertook to put this provision into effect and continued the plan for a year or two, a total of \$72,000,000 in bonds being thus purchased and distributed among the reserve banks. The coming on of the war led to the suspension of the provision which, however, had indeed been purely permissive, and eventually the effect of such suspension was merely to leave the national bank notes practically as they had been. The Federal Reserve Act having eliminated the requirement that new national banks should purchase bonds, there was now nothing whatever to stimulate the issue of national bank notes, while on the other hand the fact that an existing bank did not need to carry them, still left the holders without any market save that which was supposed to be created by the provision authorizing their purchase by reserve banks. When that was suspended and when the issue of government bonds

with high interest rate began under the Liberty loans, the national bank note situation became practically stereotyped and has continued in that condition to the present day, the amount of notes in circulation, as indicated by the report of the Secretary of the Treasury for 1922, being \$726,000,000

Results of the Currency Experiment

A survey of the currency experiment of the federal reserve system upon its original lines can be based only upon the outcome attained during the first two and one-half years of operation. This is because at the end of that time there came about so great a change in the methods of issuing and using the currency, partly as a result of the war and partly as the result of the evasive practices already referred to. The Act of 1917, amending the Federal Reserve Act, as will be seen at a later point, legalized the evasions that had been developed during the preceding years and so placed the note issue upon a totally new footing. On the other hand, the provisions of the Act of 1917, later to be studied, whereby notes were, in a sense, allowed an entry into the reserves of member banks, fundamentally altered the original theory of the law even though they were partly offset in effect by countervailing provisions whose nature will also be later traced. When the war had fairly opened the effort to draw gold into reserve banks and to issue notes in place thereof, practically made the reserve note, at least to a considerable extent, a gold certificate. Any one of these great changes would have sufficed to mask the original purposes of the act and to prevent it from showing its genuine effects.

The changed status of the reserve note has continued down to the present moment and there is now no immediate prospect, so far as can be seen, of any changes. When the time will come, if ever, that there is a recurrence to the theory of an elastic currency, or "asset currency" as it was formerly

termed, it would be only conjecture to predict. The fact remains that the experiment of an elastic currency was tried for but a few months and then only in a half-hearted way and upon a very limited scale. This should be borne in mind in all future criticisms of the Federal Reserve Act, and it should be recalled that the whole inconclusive and tentative experience which has been set forth in the present chapter affords the only occasion upon which, since the Civil War, effort had been made to introduce the elastic currency idea in practice. Remembering this fact and recalling the attitude adopted toward the elastic currency as manifested both by bankers, the officers of reserve banks, the Federal Reserve Board, and the public generally, the student may well feel an increasing degree of doubt as to the future of true bank-note currency in the United States. With this doubt he may, however, combine a question whether in fact the need for note currency is really as great as it had been supposed to be and whether in fact we have not in most parts of the country, even in the rural districts of the West, practically superseded the note by the use of the check and deposit system as a means of increasing our banking accommodation in times of urgent need for credit. As to this point, more will be said at a later stage of the discussion. The present chapter has sought to deal only with the abortive effort to introduce a currency of the kind which was so long and so urgently demanded by the so-called banking reform movement.

APPENDIX TO CHAPTER XL

Because of the importance of the note issue system in its relation with gold holdings and the reserve situation, both of which became the subject of amendment in June, 1917, the whole matter was constantly discussed during 1915 and 1916. The following memorandum, prepared by a member of the Board, touches several allied issues, but its bearing is chiefly upon the note issue question. It is therefore supplied at this point.

WARBURG MEMORANDUM ON FEDERAL RESERVE NOTE ISSUE QUESTION

Washington, December 2, 1915

To the

Federal Reserve Board
Washington

Sirs

I take the liberty of submitting the following statement and memoranda with the object in view of doing my share in establishing a basis of harmonious understanding and cooperation in the Board, without which the best results cannot be achieved

Like all of us, I regret very sincerely that the impression has been created by the press and otherwise as if there were personal differences in the Board. Personally, I cherish the conviction that differences are not of a personal nature but that we are dealing with honest differences of opinion and that the best way of removing whatever may separate members of the Board is to go to the root of these differences and to make a determined effort to agree on the essential points on which there is divergence of opinion, or, if we cannot agree, to frankly disagree upon the same and state the matter, if necessary, in the form of majority and minority reports so that it may be understood that, where differences exist, they are not of a personal nature but are based upon matters of principle. My own hope is that we may be able to agree on all of these things because, after all, that is what will best further the objects and aims of the Federal Reserve Board to which we all are devoting whatever is best in us.

If I may be permitted to analyze the situation, I would say that there are differences of opinion in the following four matters

(1) *The problem of the general functions and the policy to be pursued by Federal Reserve Banks*

I take the liberty of submitting herewith a memorandum which I have prepared covering this problem. I have no doubt that we can reach a common ground of understanding on this question.

(2) *The question of Government Deposits*

From the very beginning of the operation of the Federal Reserve Banks there have been two different schools of thought in this respect. I take the liberty of submitting a memorandum which, if adopted would, I believe, relieve the situation. It would, at the same time,

protect both the Secretary of the Treasury and the powers of supervision and control of the Federal Reserve Board

(3) *The examination and reports of member banks and rulings of the Comptroller*

This question, more than anything else, has produced irritation from time to time with member banks, Federal Reserve Banks and in the Board. I believe that we are very close to a point now where the problem could be disposed of to mutual satisfaction. Both in the case of Government deposits and the case of the Comptroller's reports the law creates a difficult situation by preserving a dual control. The problem is, can the difficulties that no doubt exist be removed by administrative methods, or shall it be necessary to cure the situation by amendments of the law so that, with respect to reports and examinations, there will be created a unity of action? As above stated, I strongly believe that it will be possible now to definitely agree upon some satisfactory plan or to state publicly the limited and legitimate degree to which we do not agree. This will cure the constant attempt of the press to magnify and to sensationalize the situation.

(4) *The question of redistricting, and, involved in that, the question of individual powers of members of the Board*

I believe that, in the very near future, the committee can bring in a report concerning redistricting which probably will dispose of any plan of dealing with this larger question but will clearly establish the position of members of the Board as to the desirability of a redistricting process at such time as it should be practicable in case Congress should give the Board the power to do so.

It will be of great advantage for the harmonious work of the Board if, at the same time, a clear understanding could be reached as to what are the individual powers of members of the Board and how far are resolutions passed by the Board binding upon all of them. I strongly believe that if we patiently discuss these questions upon their merits and entirely disregard the personal element we shall finally reach a very satisfactory and clear understanding about all of these points.

I am somewhat taking the attitude of a surgeon who rather goes to the root of an evil than deal with the surface disturbance by means of palliatives and court plaster. The process may be a little bit more bothersome while it lasts but I am sincerely convinced that it will bring more lasting and more satisfactory results. It is, to my mind, inevitable that this operation should be gone through because I can

hardly see how we can write a satisfactory report or deal with the question of amendments unless and until we have reached a clear understanding about these pending problems

Respectfully,

(Signed) PAUL M. WARBURG

MEMORANDUM ON QUESTION No. 1

The policy to be pursued by Federal Reserve Banks must be guided exclusively by the public interest

Federal Reserve Banks must neither fail to carry out transactions and exercise functions—which otherwise would redound to the benefit of the country—for the mere reason that they entail heavy expense or loss, nor must they, on the other hand, conclude transactions and exercise functions on account of the earnings to be derived, in case these transactions or functions would run counter to the public interest, or would lessen the ultimate ability of the Federal Reserve Banks to render the largest service for the general benefit of the country

In carrying out their policy they must neither compete for the sake of competition nor not compete for the sake of avoiding competition. In carrying out functions with which they are charged by the law they must compete or not compete as the public interest requires

If we agree on this premise, we must then ask ourselves, in what way do Federal Reserve Banks serve the public interest?

The function of Federal Reserve Banks is to provide a safe system of banking (free from our heretofore periodical collapses) and more stable and equal interest rates than we have had in the past

Broadly speaking, the problem of banking may be summed up in the following quotation

“If banks were to keep, in cash, all the money deposited with them, business would come to a standstill and a crisis would ensue. If banks were to lend indiscriminately to those who apply for loans all the money on deposit with them, a general panic and collapse would follow a short period of overstimulation. Between these two extremes lies the middle course, the finding of which is the problem, and its practise the art of banking.”

To find and preserve this middle course is the particular function of the Federal Reserve Bank System

The present maximum lending power of the entire Federal Reserve

System is about \$600,000,000. The total loans and investments by national banks amount at present to about \$8,000,000,000, those of the State banks to \$7,500,000,000. It is obvious that it cannot possibly be the object of the Federal Reserve System, by competition, to substitute a lending power of \$600,000,000 for that of all the banks of the country, amounting to \$15,500,000,000. The aim of the system must rather be to keep this gigantic structure of loans and investments, which is largely carried by bank deposits, from over expanding so that, as the natural and inevitable result, it may not be forced to over contract, and, conversely, to avoid over contraction with all its hardships and the inevitably resulting over expansion.

Effectively to deal with the fluctuations of so gigantic a structure is a vast undertaking for which the resources of the Federal Reserve System are none too large at this time. If the task is to be accomplished successfully, it cannot be done by operations which are continuous and of equal force at all times, but only by carrying out a very definite policy of not only employing funds vigorously at certain times but, with equal vigor, not to employ funds at others. That during periods of actual employment the Federal Reserve Banks will make large earnings and that during periods where a restricted activity of Federal Reserve Banks is rendered necessary by general conditions, their earnings should be smaller, are incidents which have no bearing upon the measure of their usefulness. Federal Reserve Banks, when accumulating funds, are exercising as useful a function as when they are employing the same. If safety and stabilization of rates form the soundest foundation for general prosperity, everything that the Federal Reserve Banks do in avoiding excessive rates, both too high and too low, redounds to the benefit of the nation, and the mere fact of the general confidence in this stability and the knowledge that funds are in reserve and available brings about the freest use of credit facilities at liberal rates all over the country. If the potential or actual employment of \$600,000,000 can have this effect upon loans and investments of \$15,500,000,000 (of which \$12,500,000,000 are loans and discounts) the usefulness of the Federal Reserve System has been proven. That does not mean that when once we shall have passed through a period of active money we shall ever have to contemplate conditions where the entire funds of the Federal Reserve Banks will lie idle. A certain proportion will always remain in active service, and there will be no doubt about their ability to earn their running expenses or that, when once they occupy their proper field of

operations—and averaging their operations over a reasonable period—they will earn their dividends, but time must be given them for this

If Federal Reserve Banks should find permanent difficulty in earning their dividends, remedy must not be sought by improperly using their funds but rather by carefully investigating whether or not organic defects exist which might be overcome. We must not forget, on the one hand, that the capitalization of the bank and the prescribed rates of dividends are arbitrarily fixed and that experience only can demonstrate whether or not these are properly chosen. Personally, I am inclined to think that they are about right, provided, however, that the Federal Reserve Banks are given the same powers as enjoyed by the European central banks with respect to the note issue. The weakness of the system, as at present devised, is that, unlike the European central banks, they cannot derive their chief profit from the note circulation. In Europe, the Banque de France, the Bank of England, the Reichsbank and the other central banks have substantially a monopoly on the note issue, and balances with these central banks and their notes are considered as cash by the banks of the country. (The Bank of the Netherlands has a capital of 20,000,000 florins and a note circulation of 300,000,000 to 400,000,000 florins.)

Our difficulty is a threefold one: first, we have a note issuing power superimposed upon an inelastic currency issued to the limit of what the country can absorb; second, our notes are not counted as reserves, the consequence of which is that, at times, like the present, when additional currency for actual circulation is not required, we do not pay for our investments by the issue of Federal Reserve notes but by a loss of gold; and, third, that our inability to issue notes against gold, or gold and commercial paper, prevents us from broadening and strengthening our banking power. At present we are tied down to the maximum of the deposits of the member banks. Gold deposited for redemption purposes with Federal Reserve Agents is a most desirable and powerful protection in case of gold withdrawals. It does not add, however, any additional banking power. It replaces but does not add. The vicious effect of these conditions is that we cannot deal boldly with the problem of Government bonds and the circulation secured by them. If we could increase our own free stock of gold, that question could be solved and, with that, the problem of our earnings.

I make free to submit a memorandum suggesting how it can be

done, and apologize for the rough form of all statements, which have been dictated hurriedly without regard to form

It is proposed to amend Section 16, clause (2) to read as follows

'Any Federal Reserve Bank may make application to the local Federal Reserve Agent for such amount of the Federal Reserve notes hereinafter provided as it may require. Such application should be accompanied by a tender to the local Federal Reserve Agent of collateral in amount equal to the sum of the Federal Reserve notes thus applied for and issued pursuant to such application. The collateral security thus offered shall be gold or gold certificates and notes and bills accepted for rediscount under the provisions of Section 13 or purchased under the provisions of Section 14 of this Act. Whenever the gold deposited as collateral with the Federal Reserve Agent shall be less than 40% of the aggregate amount of the aggregate collateral deposited, the Federal Reserve Board shall establish a graduated tax,' etc, etc

The force of this amendment would be that Federal Reserve notes could be exchanged for gold and that the gold so accumulated would become the free asset of the Federal Reserve Banks. As the law stands to-day the gold that accumulates against issue of Federal Reserve notes accumulates in the redemption fund deposited with the Federal Reserve Agent and ceases to be the property of the Federal Reserve Banks. It can not serve as a basis for additional loans, but it renders only a service—though a most important one—in being available in case of gold withdrawals. The consequence is that at present the Federal Reserve Banks are limited in their growth to the amount of obligatory balances of member banks with Federal Reserve Banks. While the optional balance may be deposited, it is not safe to count on that.

If the law should be amended as here suggested, every note holder in the country would become an additional depositor of the Federal Reserve Banks and he would become a permanent depositor, because it is safe to say that the amount of gold certificates carried in the pockets of the people at this time would be permanently carried in Federal Reserve notes. It is safe to expect that the Federal Reserve Banks would be strengthened by several hundred million dollars of gold in this manner. If three hundred millions were added this would mean an additional loaning power of 450 million dollars.

The far-reaching effect of this process would be that the Federal Reserve Banks thus strengthened could afford to deal on a broad basis with the question of government bonds and Federal Reserve notes. At present Federal Reserve Banks are disinclined—and cor-

rectly so—to adopt a policy of purchasing hundreds of millions of government bonds and issue against them Federal Reserve bank notes as long as the gold supply which they command is not larger than it is now. While it is true that they need only to maintain a reserve of 5 per cent against these Federal Reserve bank notes, it is equally true that these notes may be presented at any time for payment in gold and that, from a point of view of the Federal Reserve Banks, a 5 per cent gold reserve would be insufficient. If notes could be exchanged freely for gold the additional loaning power which would accrue to the Federal Reserve Banks by the accumulation of additional gold, could be used to provide the necessary gold reserve against a large amount of Federal Reserve Bank notes.

A very interesting suggestion has been made to the Board (by Mr. Perrin) to the effect that any National Bank the charter of which would expire, should receive a renewal charter only upon the condition that its power to issue notes against government bonds should cease, but that the Federal Reserve Banks should purchase the government bonds of these banks at par at the expiration of the banks' charter. In this manner all the government bonds would fall into the hands of the Federal Reserve Banks within twenty years. A portion of these bonds would doubtless be disposed of in the market as government 3 per cent bonds and the Federal Reserve Board and the Federal Reserve Banks would have to decide what portion they wished to carry as one-year notes and what portion as 2 per cent government bonds against which notes could be issued.

If this plan were carried out the unelastic government secured currency would be made elastic by the Federal Reserve Banks because it would be in their power to issue these notes at times when there would be legitimate requirement for increased circulation and to withdraw them from circulation at other times. Furthermore, the question of earnings of Federal Reserve Banks would be solved, because the larger the note issue of the banks, the larger would become their revenue. This revenue would be derived from the government bonds and the more government bonds would be disposed of to the public, the more important would become the commercial business of the Federal Reserve Banks, because if we take it that a certain amount of currency is required and a large portion of this currency can only be issued against the collateral of commercial paper, this commercial paper must go in the Federal Reserve Banks. Of course, if Federal Reserve notes should be made available for

reserve money of member banks (not of Federal Reserve Banks, as so many people appear to think when the question was discussed in past years¹), this process would take place with so much more effect. There is no doubt but that Federal Reserve Banks will not find their ultimate and proper place until Federal Reserve notes receive reserve qualities. At present we have the anomalous condition that the gold that comes into this country, which should accumulate in Federal Reserve Banks, accumulates in member banks, while the gold holdings of the Federal Reserve Banks hardly have grown except where the amount of the additional reserve payments had to be made under the law. We furthermore have the anomalous condition that at this time when there is no demand for additional circulation, any investment the Federal Reserve Banks make is being paid for not by Federal Reserve notes, but by a loss of gold.

While it is most gratifying to see that the bankers who so violently opposed as unsound any thought of counting Federal Reserve notes as reserve, are now of their own accord coming around to the opposite view, it still may be that Congress would not yet be prepared for such a step. It might in that case be more advisable to proceed slowly and to ask at this time only for the amendment as above outlined.

My own suggestion would be to increase the gold covered from 40 per cent to 60 per cent and begin to tax at 60 per cent, though beginning only with a very low tax and increasing only very gradually, increasing more rapidly when the gold cover falls below 40 per cent. The effect, however, would be that Congress and the country would see that it is expected normally to have a gold cover in excess of 60 per cent rather than in excess of 40 per cent and while we would expect to issue more Federal Reserve notes in this case, we would, on the other hand, expect to issue them normally on a higher basis of gold protection. This effort may ultimately be helpful in persuading Congress to permit these notes to be counted as reserve. As it is now there is no room for an elastic note issue for our elasticity has been tied to a frayed rubber band which is already stretched to the limit; the Federal Reserve Banks have no power of contracting under the present structure. As above stated, nothing will help Federal Reserve Banks more in finding their proper position and in securing sufficient earnings without being forced to use their reserve money in a way which at times would be unsafe and improper, than an effective and sound note issuing power.

MEMORANDUM ON QUESTION No 2

It is suggested that the Treasury develop gradually its accounts with the several Federal Reserve Banks. After a reasonable period of actual operation the nature and the volume of Treasury business at each point can then be ascertained as can also the expense of the Federal Reserve Banks involved in the operation of accounts. It may then be possible for the Secretary of the Treasury to determine the amounts which he proposes to carry as fixed free balances with the several banks in order to sustain these accounts.

As a matter of convenience he may arrange to have a weekly or bi-weekly settlement with the Federal Reserve Banks, by which any amounts in excess of the agreed balance be paid into the gold clearing fund for the credit of the Treasury and conversely, deficiencies below the agreed balance would be made good through the gold clearing fund.

There would then remain the free funds in the Treasury, which will vary from time to time according to the receipts and disbursements of the United States Government.

Broadly speaking, the writer doubts the wisdom of permitting these additional funds to be deposited with the Federal Reserve Banks without the control and supervision of the Federal Reserve Board.

While the resources of Federal Reserve Banks and the bulk of their deposits may be considered as "fixtures," upon which it might be safe to base a definite policy in granting loans or issuing currency, the funds of the Government, according to the wishes of Congress, may be of gigantic size and may be reduced to zero.

These Government deposits must therefore be treated from a different point of view from that of the deposits of member banks. At times, when the Government is apt to withdraw these funds, the Federal Reserve Banks should not employ them at all and keep the funds practically intact (that is the same as carrying a 100 per cent reserve against them), at times, particularly when the general banks are crowded and the Treasury balances are large, or when for other reasons it may appear advisable, it may be proper policy for Federal Reserve Banks to use freely the Government deposit and maintain a reserve against these deposits of only 35 per cent as against their other deposits. With the staggering size of our deposit structure (of 18 billions) and the limited power of expansion of Federal Reserve Banks (at present 600 millions figured on a 40 per cent basis and on the last statement of the Federal Reserve Banks)

it will be wise to keep an anchor to windward. Experience has shown that the end has always been reached or is quickly reached when a catastrophe occurs, and that it is of the very greatest value to have some large gold funds in actual reserve. For there is never enough gold in such circumstances and the value of the free treasure in the Julius Tower has been fully vindicated. It would greatly add to the strength of our system if we could keep the free treasury funds as a secondary reserve to be drawn upon after the rediscounting power between districts has been brought into full play to the highest degree compatible with safety and conservatism and at the same time with the best interest of the country.

But there must be a certain latitude in applying this rule and this elasticity would be assured if it were left to the discretion of the Federal Reserve Board from time to time to fix the reserves to be kept by the Federal Reserve Banks against Government deposits other than the fixed balances agreed upon. The Treasury could then, through the gold clearing fund, automatically deposit in the Federal Reserve System its free funds, which would be allotted to the several banks upon a certain key (based upon capitalization or capital and deposits) and be subject to special reserve requirements. In this manner the Federal Reserve Board could undertake the responsibility of supervising the employment of these funds so that the Secretary of the Treasury may be certain of his ability of withdrawing these funds when required without creating a disturbance. The power and duty of the Board of directing rediscount operations is involved in this matter. These transactions may be necessary in order to withdraw government funds from some districts and for the safety and efficiency of the system it is necessary that the Board exercise a control over these funds in the Federal Reserve Banks.

Legally there can not be any objection to a stipulation by the Secretary when making Government deposits to the effect that the deposits shall be subject to such reserves as the Board from time to time shall determine. The Board, when studying this question some months ago, was advised by counsel that even without such stipulation by the Secretary it could, by its power to tax the note issue, secure compliance with any suggestions that the Board might see fit to make to the Federal Reserve Banks in this respect.

From every point of view, however, it would appear more desirable that the stipulation, as above suggested, be made by the Secretary of the Treasury.

Memorandum by Counsel [of Federal Reserve Board] is attached

FEDERAL RESERVE BOARD
Washington

October 15, 1915

Subject Interest Charges on

Federal Reserve Notes

My dear Mr Warburg

The question whether the Federal Reserve Board may impose different rates of interest on the Federal reserve notes issued by the various Federal reserve banks involves a construction of that portion of Section 16 of the Federal Reserve Act which reads as follows

"The Board shall have the right, acting through the Federal reserve agent, to grant in whole or in part or to reject entirely the application of any Federal reserve bank for Federal reserve notes, but to the extent that such application may be granted the Federal Reserve Board shall, through its local Federal Reserve agent, supply Federal reserve notes to the bank so applying, and such bank shall be charged with the amount of such notes and shall pay such rate of interest on said amount as may be established by the Federal Reserve Board, and the amount of such Federal reserve notes so issued to any such bank shall, upon delivery, together with such notes of such Federal reserve bank as may be issued under section eighteen of this Act upon security of United States two per centum Government bonds, become a first and paramount lien on all the assets of such bank"

It will be observed that this paragraph provides in effect that any individual Federal reserve bank which has been granted an application for notes whether in whole or in part, "shall pay such rate of interest on said amount as may be established by the Federal Reserve Board"

This provision clearly indicates that the Board may charge such rate of interest as it deems advisable on any particular or individual issue of notes, and there is no intention on the part of Congress, either express or implied, which demands that the Board fix a universal flat rate of interest on all Federal reserve notes. In other words, each separate issue of notes, whether to the same or a different Federal reserve bank, may be subject to a different rate of interest.

A contrary result would defeat the obvious intent of Congress to enable the Federal Reserve Board to control, as far as possible, the conditions governing the demand for credit and to enable the Board to adapt not only rediscount rates but also the volume of Federal reserve notes to the varying needs of different sections of the country

There would not seem to be a more effective way of checking an undesirable inflation of credits than to enable the Board to impose different rates of interest on the various issues of Federal reserve notes. The paragraph quoted above clearly authorizes the Board to control not only the issue of notes to a particular bank but also to fix or determine the pressure to be put upon any particular bank to retire such notes when issued.

The fact that the authority to fix such rate of interest is in precisely the same sentence as that empowering the Board to regulate the amount of notes issued to any individual bank, indicates that Congress had in view a method of controlling the circulation of Federal reserve notes in each individual district.

The wording of this section is broad enough not only to permit of different interest rates in the different districts but also clearly authorizes the Board to charge each Federal reserve bank such rate of interest as it desires on each separate issue of notes made to that bank. The Act says that the Board may grant the application of any Federal reserve bank for Federal reserve notes, either in whole or in part, but to the extent that such application is granted, "such bank shall be charged with the amount of *such* notes and shall pay such rate of interest on *said* amount as may be established by the Federal Reserve Board." In other words, Congress specifies, in discussing the application of any Federal reserve bank for notes, that the Board may grant so much of that particular application as it sees fit and shall charge such bank with the amount of notes issued and may establish such rate of interest as it sees fit "on said amount."

It seems clear, therefore, that the Board may, at the time of granting any application for Federal reserve notes, fix such rate of interest as it sees fit to be paid on the notes issued in compliance with that particular application, and this rate is in no way dependent upon any previous rate charged to that Federal reserve bank or to any other Federal reserve bank.

It is not to be supposed, however, that, should the Board at the time of granting an application fail to fix any interest rate whatever, it is precluded from imposing any interest charge in the future, because the Act provides merely that the bank "shall pay such rate of interest as *may be* established by the Federal Reserve Board," and it may be established either at the time of issue or at any time subsequent thereto that the Board desires.

There may be considerable practical difficulty if the Board fixes different rates of interest on different issues of notes made to the

same Federal reserve bank, because of the question of determining when notes of the different issues are redeemed, but such a difficulty can in no way limit or restrict the legal rights of the Board in this connection. And it may be very easy to devise a method whereby, under mutual agreement, any notes retired by a Federal reserve bank will be assumed to be those on which the highest rate of interest is charged.

Respectfully,

Hon. Paul M. Warburg,
Federal Reserve Board

CHAPTER XLI

FIXING THE DISCOUNT RATE

Nature of Problem

One of the earliest problems which the reserve banks had to deal with was the establishment of the discount rate. As will be remembered from a reading of the Federal Reserve Act and the discussions connected with it, there was nothing that had caused so much controversy and doubt of a certain sort as had the question of the discount rate. Many had felt that in a district reserve system a uniform discount rate control would not be possible, while others who did not go so far in their views, nevertheless were of the opinion that the powers to be exercised by the Federal Reserve Board were insufficient to insure practical harmony and uniformity in the management of the discount rates throughout the entire system. These doubts and fears had undoubtedly been communicated to members of the Board. They themselves were obviously uncertain in their own minds both with respect to the working of the discount rate system and with respect to their own relation to it. Nevertheless it was necessary to get at least a tentative basis of discount rate management before the system went much further. It was not feasible to defer the matter because under the Federal Reserve Act no discount rate was enforced or legal until it had been approved by the Federal Reserve Board.

The Call for Discount Rates

Recognizing these facts the Federal Reserve Board, therefore, early in November, 1914, sent out to all federal reserve banks by telegraph a request that they recommend discount

rates on various classes of paper. It was thought best to suggest a moderate grading of the paper by maturity, but at the outset there was no effort to introduce the highly complex structure of rates which later made its appearance. A comparatively simple problem was therefore to be put to the banks for solution. This was: How should the discount rate be fixed with reference to the rates prevailing generally throughout the district in which the reserve bank was situated? Without attempting to go into any discussion of banking theory it is well at this point to recall the traditional discount rate policy of the Bank of England. As is well known, that bank has two distinct rates—the one, the so-called “bank rate” or official rate at which it stands ready to discount all paper of eligible character presented to it, the other, the so-called “private rate” which is fixed by it for paper that it obtains in the course of open market dealings through negotiations with private customers, bill brokers, and others. The theory of the Bank of England has always been that the banks should “lead the market”, that is to say, that the bank rate should always be higher than the average rate prevailing in the market generally, so that an outside bank which desired accommodation from it would have to pay a small penalty in order to get it—that is, would have to pay slightly higher than the rate which it itself was expecting to collect from its customers.

In the federal reserve system, provision was made for but one rate. The act was clear and explicit in its requirements that that rate should be uniformly made to all banks and to all discounters upon similar kinds of paper and that there should be no variation in it. The problem of discount rate establishment was thus quite different in the United States from the problem that had been presented in England during the pre-war years. To this state of things, however, but little attention was probably paid in any of the federal reserve banks and it is quite certain that little or no attention was given it by the Federal Reserve Board. It was suggested to the reserve

banks that the rates they made should be "conservative," or, in other words, high, in order that at the outset there should not be any rush of borrowers to the banks

Conflicting Views

And yet, even at this early date, conflicting views had made themselves manifest. One or two St. Louis bankers were strong in their advocacy of a rate that would "attract customers" to reserve banks, favoring the establishment of 3 per cent at the start. Others felt that the rate should be variable from time to time, practically corresponding to the rate prevailing and representing substantially the rate charged for the highest grade of paper there to be had. Still others were of the opinion that the bank rate should correspond as far as possible with the general level of "legal" rates existing in the district in which the reserve bank had its headquarters. The Reserve Board itself was without insistent theory or consensus of opinion and inclined to experiment on the banking system for a time until it could find out what the effect of the different rates would be.

The Heterogeneous Result

The result of this confusion of counsel was naturally very heterogeneous. Most of the reserve banks turned in impossible suggestions. In nearly all cases the rates were very high, not, it would seem, because of a desire to follow the Bank of England experience by leading the market, but because of the fact that the several banks, under the influence of their boards of directors, were almost morbidly anxious to avoid what looked like competition with member banks. To avoid such competition, the obvious method was that of keeping the rate up to a level that would not encourage business. This desire on the part of member banks was naturally accentuated to some extent by reason of the fact that the major part of the reserve deposits of the country were still with the banks in

the commercial centers which were expecting not to have to give them up for three years. During that period of time, it was of course their desire to hold as much of the business of their correspondents as they could, and not to encourage correspondents to shift their "trade" to the reserve institutions. So, for reasons entirely apart from the abstract theory of discount rates, early recommendations made to the Board were, as already stated, abnormally high. The Board also found that in this first set of recommendations there was very extensive discrepancy, and while it had already begun to recognize the undesirability of a discount rate absolutely uniform throughout the country, it easily saw that variations growing out of the recommendations of the several banks were too extreme. The Board, therefore, in passing upon the applications for discount rates, as was its legal duty, disapproved some and thus raised the question as to what should be the course of action to be pursued when a discount rate was not approved by the overseeing authority—a problem not specifically dealt with in the Federal Reserve Act. In its annual report for 1914,¹ it described the decision arrived at as follows:

The board had been appealed to by the authorized representatives of the several Federal Reserve Banks for some 10 days prior to the official date set for the opening of the institutions, to make suggestions to them with regard to their discount policy, for it was generally appreciated that the adoption of a fairly uniform and consistent policy to be pursued by all the banks would go far to insure the smooth working of the system. Under the provisions of paragraph (d) of section 14 of the Federal reserve act, the Federal Reserve Board is authorized to review and determine the rates of discount to be charged by each Federal Reserve Bank. The act gives power to each bank

To establish from time to time, subject to review and determination of the Federal Reserve Board, rates of discount to be charged by the Federal reserve bank for each class of paper, which shall be fixed with a view of accommodating commerce and business.

In response to a telegraphic inquiry, each bank submitted its views

¹ Annual Report for 1914, p. 10

with respect to the rate of discount thought to be advisable for its district. Upon tabulation and comparison of these results it was found that they did not vary greatly, the rates ranging from 5 to 7 per cent for 90-day paper. A study of the existing state of affairs satisfied the Board that at the start and until the banks could get a firm footing it should act with prudence and conservatism, and it was consequently voted to fix the rates of discount at from $5\frac{1}{2}$ to $6\frac{1}{2}$ per cent. The rates thus initially established were subsequently lowered from time to time upon application by the respective banks, the lowest rate thus far approved being $4\frac{1}{2}$ per cent for 30-day paper.

Dealing with Disapproved Rates

In order to meet the situation arising out of possible conflict of authority, the Board resolved not merely to telegraph its disapproval of rates, but at the same time to suggest substitute rates. This function of suggestion was, of course, not known to the law but there was evidently nothing to prevent the Reserve Board from making any suggestions that it chose whenever it saw fit, and it accordingly offered such suggestions in replying to the banks whose proposed rates were too far out of line with the general level that it had determined to establish. In the main the reserve banks whose rates were thus disapproved took the Board's action philosophically, altered their own previous action, and recommended the rates which the Board suggested. These were then approved and in due time became effective, the net result being to establish a general simple schedule of rates throughout the country at the level of about $4\frac{1}{2}$ to 6 per cent.² The first step in establishing central discount rates had thus been taken. Much more, however, was necessary than merely naming these rates in order to make them "effective." It very soon appeared that the rates so named were not effective in any sense of the term. They neither produced business nor encouraged banks to become customers, nor corresponded to the actual needs of the community, nor were they sufficiently detailed

² See appendix to this chapter for a summary of the rate situation in the several districts.

to provide for the varying classes of paper that were discounted by the system. Consequently the weeks after the initial discount rates had been approved witnessed an almost constant discussion of the discount rate function and of the exact relationship of the Board to it.

Board's Power to Change Rates

Thus had come to the front the question whether the Board, which evidently had a much broader grasp of the situation than the reserve banks in the outlying districts, had been accorded under the law any recognized means of changing rates. Must it always wait for the member banks to propose a new rate even if it knew that an existing one was unsuited to current interest? Was its function merely passive and never constructive? If it had a real constructive function, how could that best be exerted? These questions as they were more and more thought of were finally settled by the practically unanimous decision on the part of the Board that the Board's power must be exerted in some fashion toward the initiating of discount rates, and to this end it was resolved to require all reserve banks to file weekly with the Board their proposed list of rates. The Board sent to all banks in April, 1915, the following statement and request:

That the recommendations in connection with discount rates from the 12 Federal Reserve Banks may be uniform, the Federal Reserve Board has prepared the following form for such recommendations. It is to be forwarded to reach the Board not later than Thursday morning of each week.

Date———, 1915

Federal Reserve Board,
Washington, D. C.,

SIR: I have the honor to forward the recommendation that no change be made in the existing discount rates for the Federal Reserve Bank of——— for the week ending Thursday———, 1915.

Respectfully,

FEDERAL RESERVE AGENT

I have the honor to request that the following rates be approved by the Federal Reserve Board for the Federal Reserve Bank of _____ to become effective Friday morning, _____, 1915

RECOMMENDED RATES				
Maturities, in days			Agricultural and live-stock paper over 90	Acceptances
30	31 to 60	61 to 90		
PRESENT RATES				

Respectfully,

FEDERAL RESERVE AGENT

Thus, since the Board could, at intervals of one week only, approve or disapprove proposed discount rates, it was practically in the position of having a continuing veto upon rates, since if a bank recommended the same rates it already had in effect, the Board by vetoing them could compel the bank either to suspend its discount business or else to file new rates. Thus the Board practically took to itself a substantially larger power than it had originally been granted by the framers of the act, and yet in so doing the action of the Board was probably not only wise but necessary. Unless there was to be communication and discussion among the reserve banks, it was only through the exertion of a very decisive power by the Board itself that such effort could be made to succeed. Hence it seemed to be fully necessary for the Board to act constantly as a clearing house for rates, data, and suggestions concerning the fixing of discount levels, or else to assume practically the functions of a central bank in so

far as they related to the discount rate. It was the latter plan, although in a somewhat halting and imperfect sense, that represented the Board's actual course, and the decision which was arrived at was not disputed, at least in any open way, by any of the reserve banks, although it doubtless constituted a rather important encroachment upon their rate-initiating power. It is true that both the Federal Advisory Council and the so-called council of governors did at various times attempt to shape the Board's discount policy, and that there was often a difference of opinion between the governors and occasionally the boards of directors of the reserve banks on the one hand, and the Board on the other, concerning the raising or lowering of rates at specified times. The general question whether it was or was not desirable for the Board to exercise the powers which it thus in the circumstances usurped never came to an issue in any overt way, and this, as already stated, was probably because of the recognition on the part of all concerned that such an extension of the intent of the Reserve Act was almost unavoidable if the work of the system was to proceed smoothly.

Motives Controlling Discount Rates

There was, however, at the beginning an extensive and perhaps inevitable development of distrust in the rate system. Some governors of reserve banks manifestly believed that the Federal Reserve Board was not altogether single-minded in its discount policies, while the Board was by no means confident that the directorates of reserve banks were as free of prejudice or of self-interest as they might have been.

Although technically the action of the various directorates in keeping the rates very high had been in conformity with the best British traditions, there were those who believed that the motive was a more material one. The disposition in some of the southern districts, on the other hand, to lower discount rates in order to enable local banks which were

heavily "loaned up" to obtain heavy¹ accommodation from reserve banks at an expense less than they would have had to incur had they depended upon their city correspondents, afforded some further evidence of the possibly selfish motives that were likely to be operative among local bankers. Before the close of the year 1914, this ill feeling which had been brewing since the beginning had come to a definite expression, governors of reserve banks openly charging the Board with political motives in approving or suggesting given rates. The charge thus baldly and unfairly made had no warrant and the basis for it was soon dispersed when a brief investigation had shown that those really responsible for the charges had blundered. The Board wisely ignored the hasty and offensive expressions thus used and the incident perhaps served to relieve the tension which had developed rather than to increase it. This, however, did not alter the fact that there was a steadily increasing difference of opinion as to the management of discount rates as well as with regard to the relationships properly to be maintained between the line of credit rates charged at member banks and the rates of discount which the reserve banks were themselves to charge upon the same paper.

Erecting a Rate Structure

These difficulties became clearly obvious as the rate structure of the federal reserve system began to develop. As has been seen, the first rates were simple and without effort to go into more detail than was afforded by the mere classification of paper as 30, 60, or 90 days. As time went on, however, the Board adopted the plan of varying the rate structure very greatly. This was done in two ways. It was determined to vary rates according as they applied to single- or double-name paper, while at the same time preferential rates highly in favor of bankers' acceptances were agreed upon. Thus, whenever it became necessary to alter the rate, let us say,

for single-name 60-day paper, readjustments ensuing on such alteration involved, of course, a corresponding change upon 60-day two-name paper, or trade acceptances, while it also involved a readjustment of the differential between the trade acceptance and the single-name paper. It has been elsewhere noted (Book II, Chapter XXXVI) that the Board had very early been forced into the policy of granting an exceptionally low rate for paper collateraled by warehouse receipts representing agricultural commodities in storage, and had made this rate as low as 3 per cent. Such action involved many consequences that were probably not thought of when the rate was made, one of them being the making of an adjustment between this 3 per cent paper and other classes of rediscount offerings which would otherwise have won their own fate. Through these variations and adjustments a highly complex rate structure was built up, so that at the close of 1916 the rate system of the Federal Reserve Board involved at each bank a total of not less than thirteen rates, bearing in mind that a special rate was always made for agricultural paper on the ground that it was of greater length and lower liquidity than others. This meant in the entire system the possibility of twelve times as many rates as were thus indicated, although as time went on it was sought to unify as many of these rates—that is to say, adopt a uniform charge applicable at all banks—as was possible. The following tabular rate sheet representing the conditions at the beginning of 1917 is indicative of the situation that had thus been built up in the federal reserve system prior to the war. With the opening of the war entirely new conditions and problems were introduced and the country practically shifted from the commercial paper to a war paper basis. What is said in this discussion, therefore, has reference primarily to pre-war conditions, although, as will later be seen, some of these conditions were carried over to a later period.

DISCOUNT RATES

DISCOUNT RATES OF EACH FEDERAL RESERVE BANK IN EFFECT DEC 3, 1916

Maturities										Commodity paper maturing within 90 days	Paper bought in open market	Member banks' collateral loans																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																					
Discounts							Trade acceptances																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																										
Within 10 days	Within 15 days	11 to 30 days, inclusive	16 to 30 days, inclusive	31 to 60 days, inclusive	61 to 90 days, inclusive	Agricultural and live-stock paper over 90 days	To 30 days, inclusive	31 to 60 days, inclusive	61 to 90 days, inclusive																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																								
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* Rate for bills of exchange in open-market operations

† Rate for trade acceptances bought in open market without member bank endorsement

‡ Rate for commodity paper maturing within 30 days, 3½ per cent, over 30 to 60 days, 4 per cent, over 60 to 90 days, 4½ per cent, over 90 days, 5 per cent

NOTE—Rate for bankers' acceptances, 2 to 4 per cent

Difficulties of Discount Rate System

The discount rate system thus favored had its own difficulties. Not only did it require a great deal of adjustment and management in order to make it work satisfactorily, but it also presented to banks in the various districts the possibility of saving money by putting their rediscount applications through a member bank in another city. For instance, an Atlanta bank which desired to get a large line of rediscounts might arrange with a New York institution to rediscount for it with the Federal Reserve Bank of New York, such paper of course taking the New York rate which might be a little lower than the rate prevailing in Atlanta. This practice tended greatly to interfere with the development of the local discount market in the several districts which had been so earnestly desired, but was defended on the ground that it was certainly necessary so long as the reserves continued to be redeposited under the law for a period supposedly of three years with banks in other cities. There were other difficulties which grew out of the discount rate system, and it can hardly be doubted that, even had not the war intervened to change the whole current of events, the system which had been built up during the preceding two and a half years would have been greatly modified because of its cumbrous and unsatisfactory character. Of all this and more must be said at a later point when studies of the discount rate structure and the effect of the earlier war policy upon it are taken up for consideration. It is enough to note now that the Board during its early effort to apply the discount rate sections of the Federal Reserve Act had found it necessary to make a broad and liberal interpretation of the terms of the act and had then carried its authority in the matter somewhat further than the dictates of expediency and practicability seemed to permit.

Reasons for Early Errors

In all of this the margin or proportion of error involved in the work of the Board was probably a rather low one for this field of its activity. There had been no experience in the United States which would have afforded a basis for the application of the central reserve discount policy upon scientific lines, while the Federal Reserve Act was, as already seen, quite unique in its provisions relating to rates. There was not, therefore, any basis for a scientific start but such basis had to be created through discussion and, above all, through experimentation. One of the factors which the Board had found to be very powerful has already been mentioned—the reluctance of large city banks to see a rate made that would draw any business from the country banks which they desired to retain as active customers. It is necessary, however, to recognize another factor in the situation which worked in a directly opposite way. This was the fear of many of the reserve banks that they would not be able to make money. The effect of this fear was to influence the reserve banks in the direction of eventually lowering their rates below the market level and during the latter part of the pre-war period there was an unexampled drift of opinion in many districts toward such a lowering of rates. This policy was as unscientific and ill-founded as the countervailing view that rates should be kept very high in order to avoid competition with large member banks. Thus there were forces each working in the direction of error and neither checked nor modified by scientific study of banking.

Fear of Inability to Make Money

The fear of inability to “make money”—the stigma resting upon an individual who does not make or earn large quantities of money—is among the least attractive features of American business life. The federal reserve system had drawn its staff from commercial institutions, as it had to do

The men whom it thus enlisted were men of mature years whose training had been entirely received in the debilitating atmosphere of banks whose basis of judgment of worth or ability was found very largely in dividend rates and profits. The instinct, therefore, or the desire to make money and to enlarge the success of reserve banks on that basis was very strong practically from the beginning. So clearly was this obvious to the Board that it took occasion in its various annual reports from time to time to call attention to the fact that the reserve system, like every other central banking system, existed primarily for service and that money-making was only a subordinate element in its nature. In fact, perhaps, the Board went to extremes in attempting to impress upon the reserve bankers that they should endeavor to lay aside their money-making instincts and devote themselves primarily to the promotion of sound banking rather than of financial success. Yet even the members of the Board themselves frequently wearied in well-doing and from time to time became affected by the money-making instinct.

"Putting It Up" to the Reserve Banks

Thus during the late spring of 1915, members of the Board, reviewing the lean profit accounts of reserve banks, began to fear that the institutions would never earn their salt. There had already been rumblings in Congress and political criticism originating with party campaign committees based upon alleged inability of reserve banks to make expenses and the fact that they would always be a drain upon the members—a hungry hive of office holders whose expensive salaries would exhaust the financial sweetness of the country at large. There was perhaps some ground for fearing that in certain reserve banks the higher officers were inclined to feel that they had at last entered a haven of repose in which they would be free from the cares of commercial competition. At a meeting of federal reserve agents, therefore, the Board expressly asked of

each chairman when he expected his bank to be on a profit-making basis, and in most cases the answer was received that within a year from that time it might reasonably be expected that expenses would be covered and at least some progress made toward dividends. While this expectation was measurably warranted, the facts during the whole of the year 1916 never provided any sound basis for the belief that the system as a whole would at any early date begin to cover its overhead and provide a 6 per cent dividend in full to stockholders.

Fears of Competition

The perception that this situation was likely to become permanent undoubtedly led in the Federal Reserve Board to stirrings designed to bring about the application of the discount rates of the Board to open market operations. However, as will be presently seen at another point, this open market section was deferred in its application and eventually became relatively inoperative. Yet during the early months of federal reserve operation there were those in the membership of the Board who were disposed to look favorably toward a very great expansion of operating activity through the use of the open market provision. It was, of course, perceived by the opposition or "conservative" members that the success of any such policy would result in a cut in the level of rates throughout the country, reserve banks thereby obtaining the power to lead the market and, if they exercised it, probably preventing the abnormal advance of rates. How to prevent any such consummation was accordingly a problem to which various members of the Board addressed themselves.

The Return of Capital

They eventually found a solution of the problem and a cure for their fears of competition in a plan to return to the member banks the entire capital contribution which they had made to federal reserve banks. The matter was brought up

quite frankly at a meeting of the Federal Reserve Board during the latter part of 1915, and the question was plainly asked "Do we wish to ruin the banking business of the United States as the Interstate Commission has destroyed the railroad business by lowering rates?" Neither for the sake of making expenses or dividends nor for that of cutting rates to the consumer, it was argued, had a government board the right to allow itself to take part in the control of competition between the banking public and the community in a country which had fully provided for free banking and which therefore amply gave to the individual the opportunity to protect himself by the organization of new banks. In order to deprive the reserve banks of any desire to make money and in order to take away from them the outward and visible sign of success or failure found in the declaration of dividends stated as a percentage on capital, it was therefore proposed to ask Congress to authorize the return to member banks of their entire capital contributions, on the ground that this capital was no longer required since experience had shown that the federal reserve banks did not need the buffer against loss provided in the case of private banking by the contributing stock capital, while the steady accumulation of reserve funds had already placed in the hands of the banks all and more than all that could possibly be needed within any reasonable future for the purpose of providing accommodation to customers. This was the same fear of competing with members which was so largely to neutralize the open-market provision of the act through disregard of foreign central bank experience.

"Could Reserve Banks Make Money?"

The controversy regarding this question eventually reduced itself to the issue, Can reserve banks make money?—and became a theoretic discussion among the members of the Board as to the question whether the Reserve Act as then shaped could be considered to afford a real basis for the earn-

ing of profits The argument was strongly offered that as things then stood it could never be expected that reserve banks should normally make a dividend even on their small capital, or perhaps ever fully pay expenses, and to demonstrate this elaborate memoranda were submitted by members showing possible expansion of loans, rate of return at the various levels of interest, and the like The matter became a sharp issue of controversy shortly before the annual report for 1915 was sent to Congress, but no decisive outcome on the subject was ever actually reached

APPENDIX TO CHAPTER XLI

SUMMARY OF TELEGRAMS RECEIVED FROM FEDERAL RESERVE BANKS
SHOWING RATE SITUATION IN 1914

FEDERAL RESERVE BANKS AT	STATE OF RESERVES OF MEMBER BANKS	RATES PREVAILING AND DISCOUNT RATES RECOMMENDED	GENERAL REMARKS
CLEVELAND Nov 27	Banks in reserve centers average about 5% above present reserve requirements	Brokers' rate on purchased paper, 5%, only small amounts moving Suggests $5\frac{1}{4}\%$ 90 days " 5% 30 " Indications for rediscounting with us at the present rate only nominal	Smaller banks should be encouraged to continue rediscounting with large member-banks
CHICAGO Nov 25	No exact data Inquiry among member banks in Chicago indicates that new reserve requirements loosened up about 25 millions, the bulk of which is likely to be absorbed through retirement of about 25 million Aldrich-Vreeland notes and 13 million C-H certificates There has not been created any large surplus funds for loaning purposes	Rate of $5\frac{1}{4}\%$, effective December 1, will be satisfactory	Agreed that "our resources should be husbanded for later demand, and that the question of earnings is an entirely subordinate one"
RICHMOND Nov 25	No exact data for any center Before Nov 16 it is quite likely that	Funds to the north of Richmond still commanding 6% Local rate—	South Carolina apparently needs credit more than any other

FIXING THE DISCOUNT RATE

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FEDERAL RE- SERVE BANKS AT	STATE OF RESERVE OF MEMBER BANKS	RATES PREVAILING AND DISCOUNT RATES RECOMMENDED	GENERAL REMARKS
	banks at centers north of Richmond generally were short of their legal requirements, many of them having outstanding fairly large amounts of emergency currency and in some cases C H certificates. The latter are being retired rapidly, but not so the former. Fair progress during past 2 weeks in liquidation of bills payable Richmond, since its designation as reserve city, most likely has not averaged its legal requirements—difference between the probable average two weeks ago and the present legal requirements has not been great	same To the south no exceptions taken to the 6% rate, although we have inquiries as to when the figure will be lowered. Banks there apparently under great pressure for accommodation. Could properly shade our rate, and later, should we find abuse, either again raise it, or decline to accept paper,—where we might feel that an attempt is being made to abuse privileges	part of the district, Charleston and Columbia both tight. Our banks will welcome some shading, no matter how slight, in the present rate. Question of profits in the Richmond Bank itself not mentioned seriously by any member of our Board
ATLANTA Nov 27	In the city reserves have been reduced about 2 million, in the entire district roughly estimated at 15 to 20 million	Suggested change of rates 5% on 30-day paper 5½% on longer time paper	Member banks of the various districts still continue to do business with their correspondents in other districts
ST LOUIS Nov 25	Six of the 8 local member banks show \$1,627,488 surplus reserve, the two other—a deficit of \$388,000, of the 460 outside banks 90 show surplus reserve of \$955,861 and 14 a deficit of \$30,335—no data for remainder		
KANSAS CITY Nov 25	Surplus reserves in the city about 2½ million, in district—estimated from 10 to 15 million and increasing daily by reason of the marketing of crops and live stock	Present rates satisfactory, no change recommended	Liquidation has set in in a moderate but general way and the banks in reserve cities anticipate increase in deposits and surplus reserves
DALLAS Nov 25	Member banks in city show practically same percentage of reserve on Nov 24 as on Nov 16,	Reduction of ¼% already suggested would serve good purpose, though perhaps develop-	Directors and officers appreciate that a general policy is necessary toward serving

FEDERAL RE- SERVE BANKS AT	STATE OF RESERVE OF MEMBER BANKS	RATES PREVAILING AND DISCOUNT RATES RECOMMENDED	GENERAL REMARKS
	same condition believed to prevail throughout district—though have no figures	ment of further lending power should be con- sidered	situation — excluding earnings
S FRANCISCO Nov 27	Nine local member banks report surplus reserves of \$6 751,000 computed according to present law, one bank reports over 2 million additional with reserve agents	<i>Leading bankers report</i> <i>Spokane</i> Rediscount for member bankers—6-7%, R B s <i>Seattle</i> Present rate about right <i>Tacoma</i> Rediscounts— 6%, R B rate a little higher than expected <i>Los Angeles</i> Rediscounts —6%, "our rates prob- ably intended to keep our loan line down" <i>Portland</i> Present dis- counts rates are not too high, urges conservation of our lending powers for crop-moving time or sudden emergency (Nov 25)	Directors hold differ- ing conceptions of op- erating methods ' If re- discounts are restricted to choicest paper hav- ing national market, even the reduced rates recommended would induce small volume, if the purpose of the act is that we accept best paper owned by country banks, rates acceptable for this class would exclude choicest low rate paper (Nov. 25)

CHAPTER XLII

COMMERCIAL PAPER AND REDISCOUNTING

Commercial Paper Practice

With the preliminaries of the discount rate discussion out of the way, the Federal Reserve Board turned its attention, as perhaps the first serious subject of scientific investigation, to the question of commercial paper and the conditions of discounting it. The question was a knotty one—so recognized by Congress in framing the Federal Reserve Act. The difficulty in the case essentially grew out of the fact that in the United States no single or uniform standard of commercial paper had been developed. As is well known to all students of banking, practice in the United States had for years past leaned toward the development of single-name paper, while in foreign countries the discount market situation had been developed primarily upon the basis of two-name paper, either commercial or bankers'. The fact was, moreover, that in the United States single-name paper was of the most various descriptions. Some of it was as liquid and as promptly payable as any paper in the world, while other items carried under lines of credit all over the country were in many cases little more than representatives of long-deferred and many-times-renewed credit. This made it almost impossible to lay down any definite standard of "eligibility" which should be universally applied in all districts. On the other hand, the great diversity of practice and the great variation of strength among member banks of the country necessarily resulted in inability to leave the question of passing on commercial paper in every instance to the reserve banks themselves.¹

¹ The general elements of the situation were well stated in a brief sent to the Board by the New York Merchants' Association on October 22, 1914. This is reproduced as Appendix A to this chapter.

Canons of Federal Reserve Act

The Federal Reserve Act accordingly contented itself with laying down certain canons which were to govern the eligibility of commercial paper. These were of two kinds, positive and negative. Under the head of negative standards might be mentioned primarily the following:

- 1 Limitation of maturity
- 2 Prohibition of speculative purposes

Only in the event that paper was non-speculative and that it fell within designated maturities could it be regarded as eligible for rediscount.

On the other hand, the positive standards of eligibility were laid down as follows:

- 1 The paper must have grown out of agricultural, industrial, or commercial transactions
- 2 It must be indorsed by a member bank when rediscounted
- 3 It must comply with requirements to be specified by the Federal Reserve Board

Subject to these definite qualifications and limitations, the act left to the Federal Reserve Board full latitude in defining what paper was to be eligible. It was a power of the first magnitude, practically conferring upon the Board the authority to determine the distribution of credit in the United States and in a certain sense to fix the cost of such credit. The importance of this power could not be overestimated. In studying and examining into the question, the Board in preliminary discussions eventually reached the following general conclusions:

- 1 The act intended, and good banking requirements demanded, that paper to be eligible shall be "liquid."
- 2 The act authorized the rediscounting either of two-name or of single-name paper as might be desired.
- 3 The act required as nearly as possible an absolutely uni-

form standard of eligibility applicable both in country and city, and in every part of the country alike

- 4 The act made it mandatory to discount for member banks without regard to their size, provided that they furnished paper of satisfactory quality.²

Problem Narrowed

The determination of these points, of course, narrowed the problem considerably but by no means relieved it of difficulty. It was soon seen that the best results would be obtained by giving up the idea of passing upon all rediscountable paper with one sweep of the pen, and instead of that taking up different kinds of paper for successive disposal. Some of the more theoretically inclined members of the Board were desirous that a first place should be given to the bankers' acceptance, a kind of paper then practically non-existent, but more conservative counsels prevailed and it was agreed to undertake consideration first of all of the ordinary single-name "straight note" which probably constituted the great bulk of the paper held in bank portfolios at that time. Accordingly, late in 1914 the Board set about the task of formulating a regulation or general letter for transmission to all member banks whose purpose it should be to advise them of the conditions which they should require of business men's notes when presented by federal reserve banks for discount. This circular—subsequently known as "old circular No 13" because the number 13 had been assigned to it in the Board's first or original series of regulations whose earlier numbers related entirely to matters of organization rather than to those of operation—was the first general statement of policy with respect to operation which the Board ever issued. It was therefore the object of an almost unlimited amount of discussion and revision lasting for many days and eventually resulting in the transmission of the

² This followed the lines laid down by the work of the Committee of Technical Experts

circular to reserve banks and through them to members under date of November 10, 1914

"Old Circular No 13"*

The contents of this circular are therefore well worthy of analysis. Its main points, however, can be very briefly set forth. It proceeded, first of all, upon the assumption that what was to be sought was liquidity, in order that renewals might be filed and the maturity clauses of the act might be scrupulously observed. Recognizing that under the single-name note system there is no internal evidence in the paper of the purpose for which the loan has been made or the obligation given, the circular first set itself to determine a method of establishing liquidity. This it found in the requirements that the business men's notes when offered for rediscount should be accompanied by a statement setting forth the condition of the borrower and making it plain that the borrower was in such condition as to insure the use of the funds obtained by him on the note merely for the purpose of financing his current transactions and in no case for that of furnishing fixed capital or permanent working capital to the business. The member bank which offered the note for rediscount was required to have these statements on file and certify that they indicated compliance with the terms of the law as just referred to. Circular No. 13 went further and prescribed that member banks should certify that they had knowledge of the fact that the funds were to be used for the purposes set forth in the act, so that rediscounting banks practically guaranteed the application of the rediscounts received by them to objects which were consonant with the terms of the federal law. This was undoubtedly an extreme application of the theory of liquidity. It was, however, a most wholesome attitude for adoption by a government authority and should have been received with

* See Appendix B to this chapter for text

satisfaction throughout the commercial world. Had it been fully applied the effect would have been to exclude from federal reserve banks all paper except that which was obviously liquid in the sense that the funds obtained were applied to business transactions which might on the average be expected to furnish at maturity the cash with which to satisfy the bank originally making the advance.

The thought of the circular thus was to insure real liquidity in commercial credit free of those tendencies to use the banks for general financing which had in the past been found so disastrous and had so frequently produced suspension through inability to recover payment upon assets which had been supposed available at a specified time. The question was whether the commercial and banking community would be willing to live up to the terms of so stringent a requirement and to carry out in good faith the general notion of a discount market which underlay the new circular. The desirability of complying in this way with the spirit as well as the language of the act was by no means ignored. Both the press and many individuals took occasion to praise the Federal Reserve Board for the strict adherence to the principles of sound banking which it had exhibited in circular No. 13. Nevertheless the Board soon became convinced that it could not comply with the provisions of the circular without utmost difficulty if at all.

Opposition to Liquid Credit

Although no bank was willing to express itself in opposition to the idea of liquidity in credit, it soon appeared that only with great difficulty, if at all, would the support of the banks be enlisted in carrying out the idea of the circular. It must of course be remembered that in the United States, banks have for a long time permitted themselves to lend upon what is practically non-liquid security. In establishing lines of credit they have often allowed these lines to be "full" all the

time, thus practically extending permanent loans for working capital, or at most they have required an occasional "clean up" of little more value than the sporadic test of a man's physical condition which might be afforded from time to time by requiring him to go through gymnastic feats. The underlying concept of our banking system had thus been in an important way that of investment lines rather than that of credit or exchange, and the effect of it was to develop among banks a great mass of customers who ought to have gone to bond houses for their accommodation or to have solicited larger subscriptions of capital from the public, but who instead became owners of bank stock and therefore looked to their banks to supply them with what they needed. Banks of this kind, and indeed all which were carrying large quantities of non-liquid paper in their portfolios, soon became aware that under the Federal Reserve Board's ruling or regulation they could never hope to get very much accommodation from the system, and they accordingly began to protest, although not usually in public, against the rigidity of the requirement. Their criticism was essentially based upon the following assertions:

- 1 The average business man and especially the average farmer cannot furnish a "statement" that is of any particular value
- 2 In large sections of the country a request for a statement is regarded as insulting or discourteous by the borrower who is thereby alienated
3. Liquidity in the technical sense required by the Board is of only theoretical desirability because there is nothing to prevent a borrower from making another note which is then rediscounted by the reserve bank and whose proceeds are used to take up the first note

For all these reasons, therefore, demand was insistently and persistently made upon the Reserve Board for a modification or withdrawal of circular No 13

Lack of Business

Perhaps these demands, even though enforced through congressional argument and threat, would not have had any very great weight with the Federal Reserve Board had it not shortly appeared that the community was adopting a policy whose object it obviously was to isolate the Board and bring it to terms. Hardly any offerings of paper came to reserve banks. At the close of 1914 the total amount discounted and loaned was only about \$10,600,000, while the paid-in capital of the system was about \$18,000,000. This might easily have been explained, as indeed it was explained, as the result of the lack of need for the credit due to the great increase of lending power developed by the release of reserves. Such explanations were unsatisfactory, because of the fact that member banks in the large cities continued to do great volumes of business with their country correspondents. It simply was not true that the lack of business at the reserve banks was due to the non-existence of business. It was unquestionably the fact that the scantiness of operations at reserve banks was due to the fact that large member institutions had succeeded in holding their entire rediscount trade and that the reserve banks had not succeeded in making a place for themselves in any branch of it. So long as city correspondents were amply willing to advance funds upon almost any kind of paper, provided it was well collateralized or secured of eventual payment, it did not seem likely that the federal reserve system, with what were considered its absurdly high standards and high rates, could succeed in getting into the business or in attracting to itself a sufficient amount of trade even to pay expenses. There were undoubtedly members of the Board who were disposed to complain that an error had been made in starting with this effort to develop a plain commercial paper business, and to assert that had a beginning been made with the bankers' acceptance the system would quickly have worked into a field of activity in which it could have entered the open discount market and made

a place for itself instead of simply waiting for member banks to bring it rediscountable paper.

Isolating Reserve Banks

How unfounded this view actually was will appear at a later time, but at this point it is only necessary to say that the advocates of this notion were not able to make their contention good, so that there continued to be in the minds of the members of the Board the feeling that they were regarded by the banking community as Utopians and that in the effort to adhere to a very high standard of banking they had simply isolated themselves from a world which insisted upon doing business in its own way and did not care what the reserve system thought of it. Thus it was plausibly argued. We in the system actually threw away our own influence by failing to take part in the live business transactions of the community and we suffer accordingly, while depriving the country of such benefit as might otherwise have accrued from our efforts. Out of this discontented feeling, accompanied as it was by a failure of reserve bank assets to grow, came the determination to revise circular No. 13 and to bring it more into accordance with "practice" in order that reserve banks might get more business and might be in somewhat closer contact with the communities they aimed to serve. At the same time it was stated for the benefit of the public that the whole plan embodied in circular No. 13 had proved too stringent to meet the needs of the farmer, who was not in the habit of keeping books and hence could not and would not furnish accountancy statements of conditions to the bank. In the interests of the farmer, then, it was proposed to reduce the character of the requirements as to paper and to render the presentation of notes for rediscount at reserve banks considerably easier. In this endeavor the advice and suggestions of federal banks the country over were obtained through correspondence.

Report of Committee

All of the data available were eventually referred by the Federal Reserve Board to a special committee whose duty it was to consider circular No 13 and the appropriate regulations which accompanied it, with a view to finding out what trouble, if any, existed in applying the rules which had been established. The committee found that a main difficulty lay in the requirement that member banks certify that they had complete credit files concerning borrowers, it being the opinion that the country banks were generally without such credit files. It would take a long time, said the committee, to bring about a uniform understanding among country bankers as to eligible paper, and as a result it might easily turn out that erroneous certifications might be made. It was therefore suggested that a campaign of education be undertaken for the purpose of explaining to country bankers what was meant by eligibility and also to illustrate the difference between customers' paper and purchasers' paper. Accordingly it was recommended that a modification be introduced so as to require the statement to apply only to the paper of borrowers who were in the market from a professional standpoint. The requirement that the statements concerning the position of the borrower and the character of the paper be signed on oath, was regarded as repugnant to the borrower and it was suggested that he be relieved of it. As to the exclusion of bills whose proceeds were to be used in permanent investments, it was noted that in a credit system based on promissory notes it was practically impossible to earmark the proceeds of any particular note and it was suggested that this requirement should not be rigidly enforced.

The work of this committee of the reserve banks in bringing about the discontinuance of old circular No 13 has had a permanent influence upon the reserve system and the report is therefore given herewith in full as follows:

We have considered circular No 13 and regulations Nos 2, 3, 4, 5 and 6 of the Federal Reserve Board and have endeavored to ascertain the views of member banks as to their ability to comply therewith. One difficulty we find to be in regulation No 4, which requires that after January 15th, 1915, member banks shall certify that they have complete credit files in their possession concerning borrowers whose paper they offer for re-discount, including satisfactory evidence that the proceeds of short term paper is not being invested in permanent or slow investments, also, statement of the aggregate amount of short paper the borrower expects to make and his obligation to obtain the member bank's consent before exceeding the limit so stated.

We believe that the country banks which constitute the majority of our members are generally without credit files as known to the large city bank. Borrowers are personally known by the officers and directors who are usually their neighbors, and the means, business and character of such borrowers are matters of intimate personal knowledge to the bank officer.

To bring about a uniform understanding among country bankers as to what is and what is not eligible paper within a narrow or even technically exact interpretation of the Act will take a long time and a still longer time will be necessary to arrange for the filing of financial statements by borrowing customers of country banks which comply with the standard proposed. We are convinced that to require paper offered by country banks to be stamped in the manner required by regulation No 4 would result in

- (a) The stamping of the paper by country banks in a majority of cases without having a credit file of the extent indicated and desired, or
- (b) Their failure to rediscount because they have been unable to obtain such statements, or
- (c) A possible transfer of desirable accounts from National to State Banks if such information were required too soon.

It is our belief that progress in this direction may best be made by correspondence with member banks and by personal presentation of the subject by officers of Federal Reserve Banks at group and other meetings of local Bankers Associations, where the purposes and extent of regulations proposed to be made at some future date might be explained and discussed. In this way, a sentiment in favor of gradually increased safeguards could be created, so that later, when the country banks were prepared for the operation of such a regulation, it would be received understandingly and full compliance with it could be obtained at the start. We think that such compliance

as could be obtained by January 15th, on the part of country bankers would be in form in most cases, rather than in substance, and this we feel is not a desirable basis for transactions between member banks and Federal Reserve Banks

We think that a differentiation may be properly made at an early date (possibly even January 15th, 1915, but we recommend later), between paper which a bank takes from its own customers and so-called "purchased paper." Personal knowledge of the borrower's means, business and character is generally lacking in the case of purchased paper. The bank buying it must rely largely upon financial statements and inquiries from others. We believe that member banks should be induced as soon as practicable to compile appropriate credit files concerning the makers of all purchased paper and concerning such of their customers as sell their notes through brokers.

If the regulations were modified so as to apply for the present only to borrowers who sell paper in the open market, it might well be accompanied with a statement of certain essential information which would be required of that class of borrowers, and be made to apply to the first regular financial statement issued after January 15th. Many of the statements now furnished by such borrowers do not contain the information required by the regulations and are not in suitable form to make the information clear. It would not be fair or practicable to require the use of a prescribed form of statement on every note discounted after January 15th, as the information might be impossible to obtain until nearly a year had elapsed, and great confusion and possible hardship might ensue. But if all regular statements made after January 15th were required to contain the necessary information, much less difficulty would arise.

Those borrowers whose statements disclosed the existence of a debt secured by mortgage should indicate on the statement whether the lien of the mortgage covers or exempts current quick assets, such as inventories, accounts and bills receivable, cash, etc. If the lien of the mortgage does cover quick assets, a copy or digest of the mortgage should be furnished.

The requirement in Circular No. 13 that such statements should be signed under oath does not conform with usual banking practice in this country and we do not think it adds to the strength of the statement and we believe it is hardly a necessary requirement.

Regulation No. 2 excludes all Bills, the proceeds of which have been or are to be used in permanent or fixed investments of any kind. This requirement is further reflected in regulation No. 4, which

provides that the statement shall contain satisfactory evidence that short term paper is not being sold to finance permanent or slow investments. As it is impossible under a credit system based on promissory notes to follow or earmark the proceeds of any particular note, this provision, if rightly enforced would exclude in toto, the notes of a manufacturer who made any additions, however small, to his plant during a particular year unless his profits or additions to capital be an equivalent, or greater, amount. While a statement might be so made as to show clearly the policy of a borrower in financing additions to a plant so that an unwise policy in this respect would injure his credit nevertheless the prime factor in determining credit must be the proportion and character of quick assets considered in relation to short liabilities.

We consider it impracticable generally to require borrowers to agree not to exceed a specified limit of borrowing without obtaining a member bank's consent. In the case of local borrowers, this might be done sometimes but it would not be practicable in the case of large firms and corporations which have many bank accounts. It might not always be practicable to obtain the consent of all interested banks, nor would it be possible in the case of a borrower selling paper in the open market as such borrower does not know what banks hold his paper. A statement, however, showing the maximum and minimum amount of bills payable outstanding during the year would give an important indication of the extent to which such borrower is obtaining permanent capital through this means.

We would recommend a supplement relating to farmers' credit statements. All of the Federal Reserve Banks will be confronted with the problem of obtaining proper information as to farmers' paper.

The difficulty of obtaining formal statement covering such conditions seems well nigh insurmountable, and insistence upon it will render invaluable a very large volume of paper now in the hands of member banks which in their experience has proved safe and satisfactory. It is suggested that a signed statement from the rediscounting bank, based upon a statement of the maker of the paper or upon the personal knowledge of an officer of the bank as to the assets and liabilities of the borrower whose note is submitted for discount be accepted as sufficient.

The application of regulations already published (or modifications of these regulations) to the borrowing customers of member banks could we believe be more easily effected by furnishing all member banks with brief, concise statements of essential information required

in financial statements to be later filed, the requirements to be increased from time to time as experience indicates the wisdom of doing so, the important requirement of every statement being the form of verification to the effect that it contains all information including that required by the regulation necessary to a true knowledge of the borrower's credit

In suggesting that the foregoing changes should be made in Circular No 13 and regulations Nos 2 and 4, we are but following the results of our own experience, for our own credit files are scarcely started and it will take months, if not years, to bring them up to a proper standard. While recognizing the desirability of improving the credit information of member banks, we believe that in this as in other matters connected with the organization of the system, we should proceed gradually, and along lines which our experience, as we gain it, shows to be wise and practicable

Reaction to Lower Standard

In effect the committee thus favored adoption of looser method of testing eligibility pending such time as it might be practicable for the process of education to develop the practice of member banks along more scientific lines.⁴ While in some respects the reaching of this conclusion was not subject to criticism but represented possibly unavoidable compromise with expediency, the unfortunate nature of it was of course apparent. It meant that the reserve system, after only a very brief struggle and for the time being at least, surrendered the effort to put commercial paper upon a scientific basis and to apply to commercial credit those standards which are necessary to insure liquidity. The action of the Board, which followed not long after the report of the committee already referred to, was accordingly in the nature of a direct abandonment of principle which was the more regrettable because of the fact that circular No 13 had so clearly embodied sound principle in connection with banking. In the new circular which was issued early in 1915, it was provided that the regu-

⁴ The point of view in the reserve banks is shown by a letter sent to a member of the Board by a reserve agent at one of the larger banks and reprinted as Appendix C to this Chapter.

lations need not apply to loans in amounts below \$2,500. This of course exempted a great mass of the loans of the country (numerically stated) from the requirements of the regulation, and substantially placed the reliance thence forward entirely upon member banks for their judgment of paper. The elimination of the requirement of a statement under oath and some other modifications were not of very great significance as compared with this fundamental alteration of principle. Taken in the aggregate, however, they were in a very real sense a notice to banks and to the public that the reserve system was not sure of its ground upon a very essential phase of its activities. Had the action taken continued in effect for only a comparatively short time, being then superseded by new regulations, or had it even been followed by a genuine campaign of education, the withdrawal from the advanced position which the Board had previously taken would not have been so regrettable. This, however, was not the case.

Although efforts were made in a limited way in the various reserve districts to encourage the development of sound practice on the part of country banks, the regulations were never in any material degree altered, and those in effect at the close of 1922 still carried the exemption clause already referred to. Only through the process of credit study of member banks and limitation of their lines of rediscount in accordance with their condition was real effort subsequently made to bring about the observance of abstract principles of liquidity. The effort to cope directly with the business public and to encourage it in developing better and more scientific methods of borrowing was practically terminated. Whether it would ever again have been revived had not the intervention of the war deflected the attention of most reserve bankers to other subjects, would be an interesting topic of speculation. The war, however, as will be seen at a later point, caused a serious break in nearly all processes of study or normal development and nowhere was its effect so greatly marked as in connection

with banking principles. Subsequent to the close of the war new difficulties and problems presented themselves and the Board never was able to recur in any incisive way to the commercial paper discussion.

APPENDIX A TO CHAPTER XLII

BRIEF

OF THE MERCHANTS' ASSOCIATION OF NEW YORK ON COMMERCIAL PAPER FOR DISCOUNT BY THE FEDERAL RESERVE BANKS

In the second paragraph of Section Thirteen of the Federal Reserve Act the Federal Reserve Board is granted the "right" to determine or define the character of the "notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which *have been* used, or *are to be* used for such purposes" which, upon indorsement by any of its member banks, a Federal Reserve Bank may discount. The same Section adds that "nothing in this Act contained shall be construed to prohibit such notes, drafts, and bills of exchange, secured by staple agricultural products, or other goods, wares, or merchandise from being eligible for such discount" but expressly prohibits such paper when based upon investment securities. The residuary maturity of paper so accepted for discount must not exceed ninety days, except for a limited amount of agricultural or live-stock paper having a maturity of not exceeding six months. In the last paragraph of Section Thirteen there is a further grant of discretionary powers to the Federal Reserve Board by the proviso that "the *rediscount* by any Federal Reserve Bank of any bills receivable, and of domestic and foreign bills of exchange, and of acceptances authorized by this Act, shall be subject to such restrictions, limitations and regulations as may be enforced by the Federal Reserve Board."

It will be at once observed that the language of this last paragraph differs from that used in all of the preceding paragraphs of the Section in that it refers to *rediscount* instead of *discount*. In every previous reference to the process, on the part of the member banks, of obtaining an advance from their Federal Reserve Bank on the paper in their possession by indorsement, it is referred to as a "discount." And the classes of paper enumerated in the last paragraph of Section Thirteen are also different from those enumerated in its second paragraph, to which the "right to determine and define" is especially

confined. The term "rediscount" is used elsewhere in the Act only once, viz. in paragraph (b) of Section Eleven, in which the reserve bank operations are described, and therefore refers only to that process.

The amendments to the Federal Reserve Act (63d Congress Nos. 163 and 171) make no change in the above provisions, nor does the proposed amendment contained in H. R. 15038 and now reported to the House of Representatives for passage.

The question discussed by this brief may therefore be confined to the "right" to determine and define notes, drafts, and bills of exchange issued or drawn for agricultural, industrial or commercial purposes past or future as expressed in the second paragraph of Section Thirteen.

It will be observed that the power thus conferred is a "right" not a "duty". Elsewhere in the Act other functions are obligatory. It is on a parity therefore with the other large discretionary powers wisely conferred upon the Reserve Board, such as to review the division of the country into districts, to expel member banks and to restore them to membership, to suspend the reserve requirements, to add to the number of reserve cities, to add to the list of cities in which real estate loans shall not be permitted, etc., etc., and it is not mandatory upon the Federal Reserve Board to exercise that right until, and at such time, as in its judgment such determination is advisable or necessary. From the language used it may be inferred that it was in the minds of the framers of the Act that the "determination and definition" of the character of the paper thus eligible for discount might either

- A Be regulated as it is in current banking practice by self-interest and experience (modified only by the exclusions specified in the Act) or that
- B Certain further exclusions might be determined and defined by the Federal Reserve Board from time to time, when warranted by its experience and good judgment, as informed by the more thorough system of bank examination established by the Act, or
- C That a complete survey of the genera, species and varieties of commercial papers not expressly excluded might be made ab initio by the Reserve Board, formulating certain included classes, and certain excluded classes, subject to such modifications as the Board itself, from its cumulative experience might be impelled to make from time to time.

A. There is something, if not much, to be said in favor of the policy first outlined. It might be said that the indorsement of paper offered for discount by the member bank, makes those banks, in their own self-interest, anxious not to put their names on any but the best notes. To have its offering rejected once under the scrutiny of the

Federal Reserve Bank of its district would strike a distinct blow at the future credit of an offering bank. Not to scrutinize the offering with reference to the maker's name and financial condition would invite weakness and perhaps disaster to the solvency of the Reserve bank discounting such paper. With the special powers of examination of the member banks conferred upon the Reserve banks by paragraph 3 of Section 21 of the Act it should be easy for the Reserve Bank to inform itself quite accurately of the conditions surrounding any proposed or past borrowing.

Further, to throw upon the Federal Reserve banks the responsibility of passing on the eligibility of paper excepting only the exclusions of the Act itself, would, in all likelihood,

(1) Build up the responsibility and importance of the various regional banks, give their boards a wider and better experience, and render them more competent, in times of trouble, to handle a local situation without resort to the resources of the Reserve Board.

(2) Tend to make their relations to their entire membership within their districts cognate with those that have been in the main so well handled locally by the Clearing House associations, whose helpful and efficient action in troublous times has so often, since 1857, mitigated the evils produced by the periodic tendencies of men to overtrade.

(3) Give a free field to the various treatment without extraneous prejudice of certain varieties of business paper best understood in the districts where they originate. For instance, cattle paper is best understood in Kansas City, while cotton paper is best understood in Atlanta or Richmond, and mill paper in Boston. Something certainly is to be gained by the solution of credit problems in a practical rather than in an academic way, and such problems are sure to be best understood when viewed locally, at short range.

(4) Be justified by the common experience that in the issuance of clearing house certificates the classes of obligation proffered, though varying widely from place to place, have been of the best class, each in its own district, and have rarely, if ever, been brought to default, in spite of the fact that this process has only been resorted to in times of abnormal stress.

(5) Be accomplished, in the start of a new and untried system, with less friction, less local hardship, and less adverse criticism than by a series of more or less inflexible continental requirements, which might very well by the application of the *de minimis* rule discriminate against certain varieties of papers which are of a good

class within certain jurisdictions, while elsewhere fairly excludable

B It is doubtless within the powers of the Federal Reserve Board to add to the exclusions of the Act without formulating at this time a complete scheme of classes or varieties acceptable or unacceptable This course, might have the merit of definitely excluding from the portfolios of all of the Reserve banks certain classes of paper which although sometimes accepted for discount by the member banks, would, if discounted by a Reserve bank, measurably decrease the fluidity of its assets It would have the further merit of attracting the attention of less experienced and less well-trained local bankers to the undesirability of permitting a large proportion of such obligations to mingle with and thus to congeal his own assets Such less desirable varieties will be brought to your notice in the final discussion

C The case in favor of an immediate exercise of the right to make a survey of existing varieties of commercial paper, with the view of determining and defining the character of paper admissible to discount by Federal Reserve Banks, is that if such a determination could be accomplished, and well-defined classes of paper either marked for acceptance or exclusion, it would create the assurance that certain papers would surely be accepted for or discounted by the Reserve bank when offered by its member banks Everyone must recognize the value of certainty in the outcome at the inception of a business transaction Wherever such certainty can equitably be established by the declaration of a settled business principle, to be accepted by both sides in the trade, it is in the long run advantageous to all parties to the transaction In the present instance, the position of the Federal Reserve Board would naturally be that of an impartial arbiter, viewing broadly the interests of the country as a whole, of its business, as well as of its banks Unless each of these two interests, which come more or less into conflict at the making of every loan are prosperous, the other cannot be

Any consideration of the practicability of the three courses of action outlined above involves a brief discussion of the varieties of commercial paper now available for sale together with their respective merits or demerits for the loan fund of a Federal Reserve bank

All negotiable commercial paper is of one of two classes—A, Bills of Exchange, or orders to pay money, and B, Promissory Notes, or promises to pay money The two classes may be further distinguished by the time of payment, which is either on demand, or at some fixed future date Checks and sight drafts and demand bills of

exchange, differing only in form. A bank note is a demand promissory note. The questions of credit involved in these forms of commercial paper do not involve the postponement of payment, and so far as our banks are concerned no action of the Federal Reserve Board seems to be needed to work any changes in the customs surrounding their use, which adequately protect all temporary holders from loss by their acceptance.

Unsecured promissory notes bearing interest, and payable "on demand," while purporting to be call loans on personal security, are for the most part loans repayable at the pleasure of the borrower. Collateral notes payable at a fixed date or on demand, and secured by Government bonds or notes are expressly relieved from the prohibition against notes based on a pledge of investment securities and their quality with respect to ultimate payment is well established.

There remain to be considered therefore only those varieties of time paper based on personal credit or on merchandise. These are

- I Bills of Exchange payable at a specific date after sight, when accepted by the drawee—one variety of bills of exchange. It may be secured by bill of lading for merchandise which may be released or not released to the drawee upon acceptance.
- II The promissory note in settlement of sales—endorsed.
- III Notes or drafts endorsed for accommodation.
- IV The promissory note secured by pledge of merchandise.
- V The unendorsed promissory note—single name paper.

I Bills of Exchange drawn for acceptance at thirty days to six months sight, either with or without bills of lading for the merchandise attached, are now rarely used in the inland trade. They would be applicable to transactions in the great staples such as cotton, wheat, corn, oats, and other agricultural products. But transactions in these staples have been freed by the produce exchanges from time credits, and are now very generally on a cash basis. Were there a supply of this class of paper it would doubtless form one of the most solid as well as fluid forms of investment for Federal Reserve discounts. Bills of Exchange, based on sale transactions, are normally self-liquidating.

In connection with manufactured commodities such as drygoods, groceries, hardware, and the like, bills of exchange become obsolete many years ago owing to a variety of causes which may be here summarized, viz

- (a) The reduction of the customary term of credit from six or eight months to ten, thirty or sixty days.
- (b) Uncertainty of the amount due by reason of discounts offered for prepayment, by which the term of credit is made flexible, at the

buyer's option The general effect of this process is that all houses in high standing finance themselves so as to pay cash for all their purchases

(c) Uncertainty as to the amount to be paid owing to the substitution of implied warranties of the goods sold in place of the old rule of caveat emptor

(d) The change in the custom of buying, made possible by improvements in transportation during the last thirty years, whereby instead of making a few large shipments of merchandise, buyers now make a large number of small purchases While the average size of the bills in the sales of large wholesale houses in the seventies was over \$1,000 00 it is now less than \$100 00 It is not practical to settle accounts of such small size with bills of exchange (See appendix)

(e) The facilities extended to the country merchant by local banks, which have everywhere multiplied These banks find a profitable use for local funds in making loans to local merchants who are thus enabled to buy merchandise advantageously on the shorter terms now prevalent, and to avoid the long credits which in former days were furnished by the seller of the goods and paid for in the price Credit prices are always higher than cash prices

For these reasons the bill of exchange has become obsolete in nearly all branches of trade in manufactured goods, except where the conditions above referred to are upset by forced trade sales at auction In this case, notes or bills are given in payment mostly by second and third rate debtors, all others preferring, in ordinary times, to settle on short time

II What is true of the use of bills of exchange is also true of the use of promissory notes in settlement of trading accounts receivable, and for the same reasons At present such promissory notes as are given for merchandise accounts are quite well understood to represent settlements of overdue accounts receivable, or extensions granted to weak debtors, strong houses hesitate to endorse and sell these notes knowing that they are the least liquid of all their receivables, and that a transaction of this kind, disclosed, will diminish their own credit By average from $1/4$ to $1/3$ of such notes go to protest and are paid by the endorser

Promissory notes, however, are given by consumers in large volume in part settlement of debts for farm machinery, automobiles, wagons, tools, etc A large part of these notes are very good, but being drawn by persons of meagre bank credit, and not under the influence of business habits, are not always paid promptly at

their maturity Such notes are frequently endorsed and used as collateral for the promissory notes of their holders They give a self-liquidating character to the notes which they support, and should be excellent collateral security when protected by sufficient margins to forefend the average percentage of default They would seem to fall within the compass of the broad definition of the second paragraph of Section Thirteen

III Promissory notes endorsed by sureties for accommodation form the great bulk of the double-named paper held by our banks Such accommodation paper is good provided it is not used as a means of financing the inactive assets of both maker and endorser It does not represent a real transaction between them As a means of providing capital at the start for able men of limited means it is a device of value Notes of such men are dependent in a much larger degree than any other kinds of paper upon the character and ability of the maker He gets the endorsement because he needs the third element of good credit—capital The valid foundation for the prejudice against accommodation endorsement is not the fact that usually, a note so endorsed represents a *future* rather than a *past* transaction, for a past transaction is just as likely to be foolish, and therefore not to pay the note, as a future transaction But they are clouded by the question of the quid pro quo given to the accommodating endorser If a reciprocal endorsement is given in return, and secretly, there is the certainty of inflation by the production of two notes where one only is needed by trade demands They are connected in the lender's mind with the practice, of dubious morality, of not acknowledging the endorsements as liabilities, until the maker has defaulted. Nobody likes to lend money on mysteries When the endorsement is that of a concern affiliated by common ownership, it adds nothing to the responsibility behind the note, but may mislead the uninformed It is only where endorsement or acceptance, is from a party thoroughly independent of the maker that it is of any value, and in such case the nature of the consideration should be disclosed in order to forefend distrust The safety of such bills depends entirely upon an intimate knowledge possessed by the discounting bank of the character, ability and means of both parties to the transaction, and they are therefore unfitted for open market transactions And when made on a large scale, as in a recent deplorable instance, they are a distinct menace to financial weal They are in no sense self-liquidating

IV Promissory notes secured by merchandise are mentioned

specifically in the latter part of this Section of the Act. Unsold merchandise is of undeterminate value, and a note based upon it is no more self-liquidating than the merchandise itself. Like all other speculative notes they require a continual scrutiny of the markets for the merchandise by which they are secured. Such notes are often given by manufacturers for purchases of raw materials, in which case they are generally paid off when the raw material is drawn from warehouses and used in production. Notes secured by merchandise are not self-liquidating, as they require the effort of selling to provide the funds wherewith to pay.

V Single Name paper. Our modern American methods of cash or short maturity transactions, modified to a degree by customs of delivery of certain classes of merchandise in advance of the selling season, gives rise to vast amounts of book accounts receivable, payable at fixed dates, but subject to the indeterminate influences of flexible terms of credit and of implied warranties, the two collectively producing a mean variation of between two and three per cent. These being incapable of note settlement, it has become the custom of the wholesaler to obtain capital for further operations through the sale on the open market of his plain promissory note for a round amount, adjusting its maturity to that of the book accounts receivable, so as to give a self-liquidating quality to his own notes. In its current form it represents a past transaction just as much, if not so specifically as a bill of exchange. Such paper has always been in demand from bankers and in times of trouble the self-liquidating quality transmitted from the book accounts behind it has made its recurrent maturities the chief cash reliance of the banks, taking the place of the secured call loans which, theoretically liquidable on demand, are at such times congealed by the stoppage of markets, and unsaleability of collaterals. No moratorium has ever been demanded for the single name promissory note, even when the banks generally have failed in their obligation to pay cash to their depositors, or gold to their note-holders; nor even when its makers may have asked for delay in the settlement of their book accounts payable. Such notes can be put in the status of two name paper only by accommodation endorsement.

If required by law, or by regulation of the Board, two or three name paper will be manufactured to order. It will then represent the obligation of the less scrupulous of traders, and will be subject when made in a large way to the disadvantages adherent to accommodation endorsement for purposes of finance.

But it is clear, from the nature of the mercantile promissory note, endorsed or unendorsed, that it is either issued or drawn for "commercial purposes or the proceeds of which have been used or are to be used for such purposes," and so within the inclusions of the Act.

Discount Market The value to our business as well as to our finance of an open discount market, such as prevails abroad, and of an entrance into the international discount market, is not to be under-rated, even though the immediate importance of the question at this crisis may seem small. But it is clear, if our analysis of the existing stage of development of business custom in the United States is correct, that there is no way by which inland bills of exchange, such as foreign dealers are accustomed to, can be created through purely business transactions, out of the first-class obligations now current and likely to remain current in this country. If forced by law or regulation, fictitious situations can doubtless be created, which will give rise to specious imitations of the article desired, but with such transactions the more honorable part of the commercial community will have nothing to do. The only result would be to discourage straight-dealing, and to create a second-class security in place of a prime obligation such as now exists.

Out of this dilemma there are two avenues of escape. The first is the education of the foreign bill broker to our credit methods, the second is the open acceptance or accommodation for a consideration of inland trade drafts by banking institutions, such as has already been begun by several of our leading financial institutions. This practice affords the guaranty of large and imposing capitals to a finance bill capable of currency in any market of the world. Of course, in case any Reserve bank should wish to use the international market it could make bills of the very highest class by adding its endorsement to the contents of its portfolio, a process which if not now legalized might easily be the subject of legislation in the future.

It is plain from the foregoing analysis and description of the various kinds of commercial paper currently used in transactions described as admissible under the Act, that the final criterion of any given piece of paper, is the credit of its maker. That credit is dependent in part upon the character, in part upon the ability, in part upon the capital of the man or men who accept the responsibility for it by their signatures. As to whether any given piece of paper is worthy of discount by a Federal Reserve Bank is a question which must be decided by the officers of the bank itself. They have every means of arriving at a judgment on the questions involved. They

are usually close enough to the transaction which it represents to warrant a valid judgment

Considering the past success of our banking system in selecting notes of the best class for their portfolios is it not likely, at least at the start, that if unhampered by any regulations, the Directors of the Reserve banks are allowed to discount for their banks those kinds of paper with which as bank officers and as merchants they are most familiar, the best results will presently be attained? In case of any exception to this probability, the Reserve Board has three representatives on the directorate of every Reserve bank to warn it of reckless conduct or of impending trouble. Trade customs which have been built up by generations of wise and successful business men and bankers, in the slow process of adapting their methods to necessary economies in distribution, and to the needs of the seventeen hundred thousand firms, individuals and corporations actively trading in this country can not wantonly be over-turned, without peril both to the economic and moral health of the business and banking structure. And for these reasons, we urge that in exercising your right of determination and definition, or withholding from the present exercise of that right as you deem most proper, you will agree with us "that commercial paper in the present form and use be accepted by the Federal Reserve Board from member banks for discount and currency issue purposes."

Respectfully submitted,

THE MERCHANTS' ASSOCIATION OF NEW YORK,

By W A Marble, President

THE COMMITTEE ON COMMERCIAL LAW,

Edward D Page, Chairman

Welding Ring,

Donald McKesson,

Geo H Raymond,

Percival Kuhne,

Abraham Bijur,

R H Johnston,

Abram I Elkus,

Harry Dowie,

Max Naumburg,

E A Dillenbeck,

Ernest R Ackerman,

Lewis E Pierson.

APPENDIX

Computation showing result in terms of commercial paper issues and of office detail of changing present short-time system of settlement in sales of manufactured goods to that of settlement by four months' bills of exchange

The merchandise is supposed to be at first cost, of \$12,000 annual value, distributed from manufacturer to wholesaler at the rate of \$1,000 per month in two equal shipments of \$500 each, and from wholesaler to retailers, with 20 per cent gross profit, also in equal monthly installments in forty shipments averaging \$30 each

	Debt Created	
A <i>On present terms (say average 15 days)</i>		
Constant debt from wholesaler to manufacturer	\$ 500	
Note of manufacturer to carry this debt with 20 per cent margin	\$ 400	
On average of 40 days, constant debt from retailer to wholesaler		1,600
Note of wholesaler to carry same with 20 per cent margin	1,300	
Constant debt created		\$2,100
In 1 year, total of 6 mos paper (4 pieces) created under plan A	\$1,700	
B <i>On four months' credit settled by bill of exchange or note:</i>		
1 Transaction between manufacturer and wholesaler, due continually 4 x 1,000		4,000
2 Transactions between wholesalers and retailers, due continually 4 x 1,200		4,800
Constant debt created		\$8,800
Notes needed to settle debt from wholesaler to manufacturer, 8 of \$500 each	= \$4,000	
Notes needed to settle debts from retailers to wholesalers, 160 of \$30 each	= 4,800	
In 168	\$8,800	
In 1 year, total number of pieces created of 4 mos paper 168 x 3	= 504	
Results compared	Amount	Pieces
Note settlement basis—paper outstanding	\$8,800	
Notes annually required		504
Present settlement basis—paper outstanding	1,700	
Notes annually required		4
Increase	\$7,100	500
Increase in outstanding paper	417%	
Increase in annual office operations		12,500%

APPENDIX B TO CHAPTER XLII

CIRCULAR No 13

FEDERAL RESERVE BOARD,
Washington November 10, 1914

To all Federal Reserve banks

In view of the impending opening of the Federal reserve banks, the Federal Reserve Board deems it proper to outline in this circular, in broad general terms, the discount policy which it believes might be pursued to advantage by the Federal reserve banks at the outset.

While the most acute stage of the recent financial emergency appears to have passed, the conditions in other countries make it necessary that the United States should to the utmost degree of efficiency, organize and make available its own resources in order that it may provide for its own needs and replace the facilities suddenly destroyed by the closing of so many of the accustomed channels of credit and trade.

The directors and governors of the Federal reserve banks at a conference in Washington on October 20 and 21 recommended that the banks be opened without attempting at the outset to perform all the functions and duties contemplated in the act, but that they be prepared to accept deposits or reserves payable in lawful money, to discount bills of exchange and commercial paper and to accept the deposit (after the reserve payments had been made) of checks drawn by member banks on any Federal reserve bank or member banks in the reserve and central reserve cities within their respective districts. It was the opinion of the conference that arrangements for the exercise of the additional powers granted by the act to the Federal reserve banks be completed as rapidly as the establishment of safe and efficient organizations would permit. The Federal Reserve Board is in accord with these suggestions.

It should be borne in mind that, although our exports are showing a gratifying increase, there is still a large cash balance due to European countries for which gold may be demanded and that a large quantity of American securities held abroad may be returned to the United States, while on the other hand more than \$300,000,000 of emergency currency must be gradually retired. No one can estimate the duration of the war or predict what will be the financial and commercial conditions when peace shall be restored. Our own industrial development has been greatly facilitated by foreign capital, and we have been accustomed to borrow large sums annually in Europe and to sell American

securities there, which attracted foreigners because of their higher rate of return as compared with European investments. It is probable that at the end of the war interest rates in Europe will be higher than they have been in the past and greater investment returns will be yielded. The tremendous destruction of property and waste of capital will not only check the flow of European savings to the United States, but may dispose foreign investors to return us the securities they now hold. Lower money rates in this country would be likely to accentuate this tendency, while, on the other hand, higher interest rates and larger investment returns on our side would check it.

The function of the Federal reserve banks is, therefore, of a two-fold character. They should extend credit facilities, particularly where the abnormal conditions now prevailing have created emergencies demanding prompt accommodation, and, on the other hand, they must protect the gold holdings of this country in order that such holdings may remain adequate to meet demands that may be made upon them. While credit facilities should be liberally extended in some parts of the country, it would appear advisable to proceed with caution in districts not in need of immediate relief and to await the effect of the release of reserves and of the changes which the credit mechanism of the country is about to experience before establishing a definite discount policy.

Commercial paper—The Federal Board, under section 13 of the Federal reserve act, has the right to determine or define the character of paper eligible for discount, to wit, "notes, drafts, and bills of exchange arising out of actual commercial transactions, that is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used or are to be used for such purposes."

Bearing in mind the requirements of the present situation, the Federal Reserve Board believes that it would be inadvisable at this time to issue regulations placing a narrow or restricted interpretation upon the section defining the character of paper eligible for discount. It has therefore been decided not at this time to enter upon the discussion of the question of single or double name paper, but to admit both forms of bills to rediscount with the Federal reserve banks.

The Federal Reserve Board proposes, however, to prescribe the following basic principles for the guidance of Federal reserve banks and member banks:

(a) No bill shall be admitted to rediscount by Federal reserve banks the proceeds of which have been or are to be applied to per-

manent investment, and regulation No 2 has been formulated with the intention of giving effect to this principle, and is herewith inclosed

(b) Maturities of discounted bills should be well distributed. It is the well-established practice of European reserve banks to invest only in obligations maturing within a short time. It is a general rule not to purchase paper having more than 90 days to run. The maturities of these notes and bills are so well distributed as to enable those banks within a short time to strengthen their hold on the general money market by collecting at maturity or by reinvesting at a higher rate a very substantial proportion of their assets. Acting on this principle, the Federal reserve banks should be in position to liquidate, whenever such a course is necessary, substantially one-third of all their investments within a period of 30 days. Departure from this principle will endanger the safety of the system. It is observance of this principle that affords justification for permitting member banks to count balances with Federal reserve banks as the equivalent of cash reserves.

(c) Bills should be essentially self-liquidating.

Safety requires not only the bills* held by the Federal reserve banks should be of short and well-distributed maturities, but, in addition, should be of such character that it is reasonably certain that they can be collected when they mature. They ought to be essentially "self-liquidating," or, in other words, should represent in every case some distinct step or stage in the productive or distributive process—the progression of goods from producer to consumer. The more nearly these steps approach the final consumer the smaller will be the amount involved in each transaction as represented by the bill, and the more automatically self-liquidating will be its character.

Double-name paper drawn on a purchaser against an actual sale of goods affords, from the economic point of view, *prima facie* evidence of the character of the transaction from which it arose. Single-name notes, now so freely used in the United States, may represent the same kind of transactions as those bearing two names. Inasmuch, however, as the single-name paper does not show on its face the character of the transaction out of which it arose—an admitted weakness of this form of paper—it is incumbent upon each Federal reserve bank to insist that the character of the business and the general status of the concern supplying such paper should be carefully examined in order that the discounting bank may be certain that no such single-name paper has been issued for purposes excluded by the act, such

* For brevity's sake, the words "bills" and "notes" whenever used in these paragraphs include bills, notes, and drafts, as specified in the act.

as investments of a permanent or speculative nature. Only careful inquiry on these points will render it safe and proper for a Federal reserve bank to consider such a paper a "self-liquidating" investment at maturity.

Turning now to the question of procedure, it is not thought necessary to impose upon the banks the observance of methods which would involve needless difficulty or delay. It is therefore not deemed essential that a statement of condition be attached to each bill when sold to a Federal reserve bank. It is however, thought advisable by the board to require that on and after January 15, 1915, no paper shall be discounted or purchased by Federal reserve banks that does not bear on its face the evidence that it is eligible for rediscount under the principles and definitions above outlined and as expressed in regulation No. 2, and that the seller of the paper has given a statement to the member bank. A rubber stamp stating, in substance—

ELIGIBLE FOR REDISCOUNT WITH FEDERAL RESERVE BANKS UNDER REGULATIONS OF FEDERAL RESERVE BOARD CIRCULAR NO. 13 CREDIT FILE NO. _____ DISTRICT NO. _____ (Name of Member Bank)
--

is considered sufficient evidence to that effect at this time. It would be understood that the Federal reserve bank could at any time call for the appropriate credit file, and it may be expected that the data thus gathered—particularly the files of more important firms and of those rediscounting in larger amounts—will be so catalogued as to furnish the nucleus of an effective credit bureau which, in turn, may eventually develop into a central credit bureau for the benefit of all the Federal reserve banks of the system.

For the time being certified accountants' statements will not be required. This matter is reserved for regulation at a later date. The required statement as outlined above should be signed under oath and should contain a short general description of the character of the business, the balance sheet, and the profit and loss account. Assets should be divided into permanent or fixed investments, slow assets, and quick assets. On the liability side should be shown capital, long-term loans, and short-term loans. Short-term loans should be in proper proportion to quick assets, and the statement should contain satisfactory evidence that short-term paper is not being sold against permanent or

slow investments. The statement should furthermore show the maximum aggregate amount up to which the concern supplying this paper expects to borrow on short credit or sale of its paper, and the concern giving the statement should obligate itself to obtain the member bank's consent before exceeding the agreed limit. The affixing of the stamp stating such paper to be eligible for rediscount will be considered a solemn and binding declaration by the member bank that the statement has been examined from this point of view and that the paper bought complies with all the requirements of the law and the regulations hereby imposed.

The board appends two additional regulations. No. 3, covering discount transactions on or before January 15, No. 4, discount operations on and after January 15.

Six-months' paper — The law provides that the Federal Reserve Board shall fix the percentage of its capital (by which is understood that portion of the capital paid in) up to which a Federal reserve bank may discount "notes, drafts and bills drawn or issued for agricultural purposes, or based on live stock and having a maturity not exceeding six months." The law permits the Federal Reserve Board to deal with each Federal reserve bank individually in fixing this limit.

The Federal Reserve Board has determined to fix this limit generally, and until further notice, at 25 per cent of the capital that shall have been paid in from time to time. For those districts in which, during certain seasons, six-months' paper is particularly required to carry through agricultural operations, the limit will be increased from time to time upon requests made by Federal reserve banks to the Federal Reserve Board.

Regulation No. 5, relating to six-months' paper, is appended hereto.

Regulation No. 6, relating to bank acceptances, is likewise appended.

CHARLES S. HAMLIN, Governor

APPENDIX C TO CHAPTER XLII

LETTER ON ELIGIBILITY OF COMMERCIAL PAPER WRITTEN BY A FEDERAL RESERVE AGENT TO A MEMBER OF THE FEDERAL RESERVE BOARD

December 19, 1914.

Dear _____,

Since telephoning you this noon, I have been thinking how to intelligently put down on paper any suggestions, which might be of assistance to you in connection with any modification you may make of Circular No. 13 and the accompanying regulations. The Circular

and the regulations are so bound up together, both being mentioned in the rubber stamp required to be used after January 15, 1915, that I do not know how to proceed with something specific in the absence of knowledge of what you yourself have in mind in the way of a modification

I gather that you are ready to distinguish between "Customer's Paper" and "Purchased Paper," and enclose a suggested definition of the two. The most I feel that I can do at this time and until I have some draft from you showing the manner in which the modifications are to be presented, is to suggest the points which it might be well to consider taking up in the modification. I will suggest them under topics, as follows

PURCHASED PAPER

1 That on and after January 15, 1915, no bank shall offer for rediscount with a Federal reserve bank purchased paper unless it has in its possession a statement of the seller, whether maker or endorser, of such paper, and sufficient information to enable an officer to certify that to the "best of his knowledge and belief it is eligible for rediscount with Federal reserve banks under Regulation No. _____ of the Federal Reserve Board." It would be impracticable for each member bank to have a signed original statement, but it might have a copy signed by a notary public certifying that it is a correct copy of an original statement on file with the note broker

2 If it is desired to prescribe the form of statement, and I am not at all sure that this might not profitably be done in the case of purchased paper, it would be well to provide that all statements given after a certain date, should be made upon the standard form. By the arrangement of the items you could bring out the essential credit features of the statement and put in a number of questions to be answered which would draw out the dark things, if any, in the condition of the concern making the statement

3 As suggested to you in Washington, I feel that it is impracticable to make a concern obligate itself to obtain a member bank's consent before exceeding an agreed limit of borrowing. I think we agreed that the proportion between current liabilities and quick assets was the thing which should determine the credit rating of a statement, and that it would be impossible to tell whether in a statement in which the quick assets exceeded current liabilities, short term paper was being sold against any permanent or slow investment. Tendencies of this kind could most easily be discerned from a comparative balance sheet

and you might very properly require the statements furnished to contain, say, the 1914 as well as the 1915 statement, side by side, for the purpose of comparison, in this way one could easily see whether the concern is putting current funds into the plant. You will remember that in the 11th paragraph on page 2 of Regulation No. 2, accompanying Circular No. 13, the language is very rigid as to any notes whose proceeds have been used in any fixed investments. The principle is all right, but it is next to impossible with our system of promissory notes in round amounts for a member bank to certify, with any certainty, that no part of the proceeds of a particular piece of paper, has gone into fixed investment.

4 I think we have agreed that the signing under oath should be omitted.

5 I think it would be advisable to omit, for the present at least, requiring a statement of the Profit and Loss Account. This is a matter which many concerns object strenuously to disclosing, and I should suggest that, at the start at least, the inclusion of a Profit and Loss Account should be optional. If you get out a statement, put in a place for it, and recommend that good business practice requires its inclusion, but do not insist upon it. Then if a fellow leaves it out, people will want to know why, and gradually most concerns will include it. Then, after a proper period of this kind of evolution, you can make it a requirement.

6 I should urge strongly postponing requiring statements of certified accountants for the present, and not state a definite date upon which they will be required. The following are the reasons:

(a) The very fact that you indicate that sooner or later certified accountants' statements will be required, will gradually accelerate the giving of such statements by concerns selling paper. Thus it will come about in a natural way, and many of the note brokers are even now urging it strongly on the strength of your indication that it will later be required. If you require it now with all the other changes and new features incident to the inauguration and early operation of the Federal Reserve System, it will simply be one more hard place to get over.

(b) Another reason is that the term "certified accountant" has many meanings. Only a few States have good certified accountancy laws and registration, and if you require a certified accountant's statement, you will also have to provide a definition as to who shall be considered a certified accountant, which, I know from experience, will be a mighty difficult matter when you are covering a nation wide

situation I believe that in a year, or two years, you will find a great increase in the use of certified accountants, and if you like I should be glad to go into this matter with the note brokers and get some suggestions upon it from them for you

CUSTOMER'S PAPER

1 Customer's paper might bear the same endorsement on the back as Purchased Paper with the exception of the omission of "Credit File Number" I am not sure that in any case this is a particularly good designation as I do not think banks usually keep their credit files by number

2 I understood from you, over the telephone, that your plan was to postpone requiring the credit files for Customers' discounts until further notice In the absence of credit files, I think it would be well to explain by examples, if this seems practicable, what customers' paper may be considered eligible The country banks have never thought much about the liquidating characteristics of their paper, and from talking with their officers, I gather that they are prone to jump to the conclusion that no paper is self-liquidating unless the discounter goes out of debt completely every year Frequently, the discounter borrows the money year in and year out with some fluctuations, as more or less permanent working capital This may not sound well on the face of it, but, as a matter of fact, only a very small percentage of the great volume of purchased paper is made by concerns who go out of debt every year Most of them have a high point and a low point, the variation representing the seasonal fluctuations in their business It is only by looking at the statement that you can tell whether it is a proper note to buy I think the country bankers need some encouragement as to the eligibility of their customers' paper, and I believe a few concrete instances would be the easiest for their minds to grasp They are not very quick at catching general principles They are afraid that none of their paper may be considered in the language of the first paragraph on page 3 of Circular No 13, "a self-liquidating investment at maturity" The fact is, I believe, they have lots of eligible paper under any reasonable construction, and as they are, and are likely to continue to be, the principal kickers at the system, it would be well to endeavor to enlighten their minds on this point.

3 It might be well to suggest that they should proceed, wherever practicable, to get statements from their borrowers, whose paper they are likely to discount and to begin to accumulate credit files so as to

enable them to furnish necessary information to their Federal reserve banks

4 Many a local factory has Bills Receivable from its customers all over the country, these it discounts with the local member bank I assume that it is not expected that a credit file shall be obtained by the bank as to the makers of these notes, but merely as to its own customer, the discounter

5 With regard to "merely investments" this point should be made clear, a brick manufacturer sells a carload of bricks to a builder The builder gives the manufacturer his note covering the shipment The manufacturer discounts this at his bank With regard to the maker, it is "merely investment", with regard to the discounter, it arises out of a commercial transaction Perhaps the expression, "the *proceeds* of which have been used for commercial purposes" would cover this point, but it is not at all clear to the country bankers

GENERAL

I suggest that consideration be given to the desirability of encouraging the use of a form of note, as proposed in the enclosed circular of the New York Clearing House, in which the maker represents that the note has arisen out of commercial, etc, transactions or in some way which would put the original burden upon him This would help more potently than anything else to begin the standardization of eligible promissory notes I have nothing very definite to present on this to-day, but if the idea appeals to you at all (and you very likely may have discarded it as impracticable), I will try to take it up in the near future with competent people here

Yours very truly,

Federal Reserve Agent

The New York Clearing House circular referred to above was as follows

NEW YORK CLEARING HOUSE

March 2d, 1914

Dear Sir

For your information please find copy of Correspondence between the Reserve Bank Organization Committee and the New York Clearing House Committee

Respectfully,

WILLIAM SHERER,
Manager

A H WIGGIN,
Chairman Clearing House Committee

RESERVE BANK ORGANIZATION COMMITTEE
Washington, D C

February 6th, 1914

Sir —

Section 13, page 14, of the Federal Reserve Act provides, among other things, as follows

"Upon the indorsement of any of its member banks, with a waiver of demand, notice and protest by such bank, any Federal reserve bank may discount notes, drafts, and bills of exchange arising out of actual commercial transactions, that is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes, the Federal Reserve Board to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this Act"

It will be observed that the paper thus made eligible for rediscount is defined as that arising out of "actual commercial transactions the proceeds of which have been used, or are to be used, for such purposes"

The true definition of "commercial paper" or "commercial transactions" gives rise to a great difference of opinion on the part of bankers generally, and is susceptible of a very broad or very narrow interpretation. The point has been frequently raised, and insisted upon, that "commercial paper" in a purely technical sense should be construed to mean obligations which represent the purchase price of some commodity sold.

Attention has been called to the fact, however, that trade customs in the United States have developed along lines which would limit such paper to a proportionately small amount if this strict and technical interpretation were adopted.

In other words the established practice now appears to be that instead of the purchaser executing his note to the vendor for the whole or any part of the purchase price of the commodity sold, it has become customary, in order to obtain the benefit of cash discounts, for the purchaser to borrow directly from the banks and to use the proceeds of such loans to make the payment due the vendor. This being true, the question of identification of Commercial Paper presents some practical difficulties.

In the exercise of the power vested in the Federal Reserve Board to determine or define what shall be treated as "commercial paper" the Committee is of the opinion that the Board will desire to have before it the views of practical bankers so that the matter may be considered from all important standpoints.

With this in view, I am directed by the Committee to ask your Clearing House to give consideration to this provision of the law, and to submit on or before the first of March, 1914, a suggested definition of "commercial paper" and also to submit such suggestions or recommendations as to standard forms of Notes, Drafts, and Bills of Exchange covering the various kinds of commercial transactions as may seem to you advisable, to the end that there may be established, as far as possible, a uniform practice among all Federal Reserve and member banks with respect to the creation of the eligible paper provided for in the Federal Reserve Act

The Bill furthermore provides, in section 16, page 19, as follows

"The Federal Reserve Board shall make and promulgate from time to time regulations governing the transfer of funds and charges therefor among Federal reserve banks and their branches, and may at its discretion exercise the functions of a clearing house for such Federal reserve banks, or may designate a Federal reserve bank to exercise such functions, and may also require each such bank to exercise the functions of a clearing house for its member banks."

The Committee also directs me to request that you give consideration to this provision of the Act and submit for its consideration suggested regulations governing the transfer of funds, and the charges therefor, among the Federal reserve banks and their branches, and also submit your views and suggestions as to how the Federal Reserve Banks themselves could best perform the clearing house functions contemplated in the Act

Any suggestions that you may deem advisable to make in connection with these two provisions will receive consideration and be appreciated by the Federal Reserve Board

Respectfully,

(Signed) M C ELLIOTT,

Secretary Reserve Bank Organization Committee
President New York Clearing House Ass'n,
New York N Y

NEW YORK CLEARING HOUSE

February 27, 1914

M C Elliott Esq

Secretary, Reserve Bank Organization Committee,
Washington, D C

Dear Sir —

Your letter of the 6th instant, addressed to the President of the New York Clearing House Association was submitted by him to the Clearing House Committee for their attention

We have given careful consideration to the inquiries put by the Reserve Bank Organization Committee as set forth in your letter, and duly appreciate the importance of arriving at such definition of the character of paper eligible for discount by the Federal reserve banks as shall meet the requirements of the business of the country in respect of providing an elastic and stable currency, and, at the same time, provide a definite measure of security

It is obvious that what the Organization Committee desires is not so much a technical, however accurate, definition of "commercial paper," or "commercial transactions," or "commercial purposes," as the same may be understood in the general sense by bankers or lawyers, but an expression of views as to how the Federal Reserve Board, acting within the powers conferred upon it by the Federal Reserve Act, shall "determine or define what shall be treated as commercial paper," eligible to discount, in order to carry out the true purpose of the Act

The terms "commercial transactions" and "commercial purposes," in their broadest sense, would cover any transaction and any purpose connected with commerce. Commerce is not confined to the buying, selling or bartering of commodities, but is a term of large significance, and as was said by Mr Justice Harlan, of the United States Supreme Court, "comprehends traffic, intercourse, trade, navigation, communication, the transit of persons, and the transmission of messages by telegraph—indeed every species of commercial intercourse which is carried on between man and man"

The purpose of the Federal Reserve Act is primarily "to furnish an elastic currency, to afford means of rediscounting commercial paper" That it was not intended that all paper that might by strict construction come within the general definition of commercial paper should be eligible for discount at a Federal reserve bank is made clear by the provisions of Section 13 of the Act, and especially by the clause excluding "notes, drafts or bills covering merely investments, or issued or drawn for the purpose of carrying or trading in stocks, bonds or other investment securities, except bonds and notes of the Government of the United States" It is unnecessary, therefore, to attempt to define commercial paper in its broadest sense. A fundamental requirement is that the paper shall be used not only in connection with the commerce of the country, but that it shall be either directly used in the purchase of commodities or that the proceeds shall be intended to be so used, so that it will have the presumptive security of the commodities, or the avails of a resale thereof, back of it. The custom in this country of sellers of commodities granting discounts

for what are known as cash payments has resulted in the practical abandonment of former trade methods whereby the purchaser gave his note to the order of the seller in completion of the transaction, and in the establishment of the practice of bank borrowings by purchasers for the procurement of funds with which to discount their bills. Although such practice could not well be discontinued abruptly, nevertheless we deem it a matter of the utmost importance that there should be a general restoration of the former conditions in this respect. The use of acceptances abroad is a prime factor in the open discount market and a similar system should prevail in this country. The purpose of issue of that class of paper is apparent on its face, and as it retires itself automatically it is an efficient aid in making an elastic circulation. It is evident from the language of the Federal Reserve Act that the advantages of this system were appreciated, and we urge that every legitimate effort be made to encourage its general adoption. One aid to that end that suggests itself is the establishment of a difference in rates by the Federal reserve banks which would favor commercial paper of the class referred to. In the meantime, we realize that existing conditions must govern in the determination by the Federal Reserve Board of the character of paper that shall be eligible to discount by the Federal reserve banks. Having in mind the essential requirement of approximately liquid, or quickly marketable assets, presumptively back of the paper and the limitations expressed in the Act and its general purposes we would suggest that promissory notes of each of the above mentioned classes, to be so eligible for discount, may be defined as follows:

(a) A written instrument negotiable in form, made by a merchant or manufacturer, or a corporation engaged in either of such occupations, whereby the maker contracts to pay, at some fixed or determinable future time, a definite sum of money stated therein for the procurement of funds to be used in payment for goods, wares or merchandise intended for resale in some form, but not in the form of real property, and not merely for investment, and which shall bear the endorsement of the payee, and which has not been issued for the purpose of carrying or trading in stocks, bonds or other investment securities, and which shall have a maturity in conformity with the requirements of the Federal Reserve Act.

(b) A written instrument negotiable in form, whereby the maker contracts to pay, at some fixed or determinable future time, to the order of some merchant, manufacturer, farmer, dealer in live stock or agricultural products, or mine owner, or a corporation engaged in any such occupation, a definite sum of money stated therein, representing in whole or in part the purchase price of goods, wares or merchandise purchased by the maker from the payee, and intended for resale in some form, but not in the

form of real property, and not merely for investment, and which shall bear the endorsement of the payee, and which shall not have been issued for the purpose of carrying or trading in stocks, bonds or other investment securities, and which shall have a maturity in conformity with the requirements of the Federal Reserve Act

(c) A draft or bill of exchange, for the purposes of the Act, may be defined as

An unconditional order in writing addressed by a merchant, manufacturer, farmer, dealer in live stock or agricultural products, or a mine owner, or a corporation engaged in any such occupation, to another person or corporation, signed by the person or corporation giving it, requiring the person or corporation to whom it is addressed to pay, at a fixed or determinable future time, a sum certain in money to order, and which shall have been accepted by the drawee, and shall have been drawn for the purchase price of goods, wares or merchandise sold by the drawer to the drawee and intended for resale in some form, but not in the form of real property, and not merely for investment, and shall not have been issued, drawn, or accepted for the purpose of carrying or trading in stocks, bonds or other investment securities, and which shall have a maturity in conformity with the requirements of the Federal Reserve Act

(d) The usual and customary form of notes, drafts and bills of exchange which are directly secured by staple agricultural products, or other goods, wares or merchandise, and such as have been issued or drawn for the purpose of purchasing or of carrying or trading in bonds or notes of the Government of the United States, and which shall have a maturity in conformity with the requirements of the Federal Reserve Act

The next question to consider is as to how the banker is to determine the qualification of the maker of the note, or the drawer of the draft or bill of exchange, and as to whether or not the paper is to be used for the purposes hereinabove specified. Although the requirement of endorsement by member banks seeking rediscount carries with it a contingent liability measured by the amount loaned thereon by the Federal reserve bank, nevertheless, it would obviously be placing too great a burden upon the member banks to require them to assume any other responsibility for all of these facts. We suggest, therefore, that a standard form of promissory note and draft or bill of exchange should be prepared which will contain representations on the part of the maker, and in some cases also of the payee, of the note, and of the drawer of the draft or bill of exchange, to cover these requirements, and that some penalty shall be provided by law for any false statement in these particulars.

We would suggest, merely by way of illustration, the following forms.

FORM No 1

\$ New York, 191

after date, the undersigned, for value received, promise to pay to
or order, at

Dollars

The undersigned represents that (he, she or it) is a (merchant, or manufacturer, as the case may be) and that this promissory note is given for the procurement of funds to be used in payment for goods, wares or merchandise intended for resale in some form, but not in the form of real property, and not for investment nor for the purpose of carrying or trading in stocks, bonds or other investment securities

FORM No 2

\$ New York, 191

after date the undersigned, for value received promise to pay to
or order at

Dollars

The undersigned and the above-named payee each represents that the said payee is a (merchant, or manufacturer or farmer, etc. as the case may be), and that this promissory note is given for goods, wares or merchandise purchased by the maker from the payee, and intended for resale in some form, but not in the form of real property, and not for investment nor for the purpose of carrying or trading in stocks, bonds or other investment securities

FORM No 3

\$ New York, 191
days after , pay
to the order of

Dollars,

value received, and charge the same to account of the undersigned who represents that (he, she or it) is a (merchant, or manufacturer, or farmer, etc., as the case may be) and that this bill of exchange has been drawn for the purchase price of goods, wares, or merchandise sold by the drawer to the drawee and intended for resale in some form, but not in the form of real property, and not for investment nor for the purpose of carrying or trading in stocks, bonds or other investment securities

To Messrs.

It may be urged that borrowers mangle their funds and ought not to be held accountable theretore for the strict application to the purpose specified of the particular moneys borrowed upon paper of the character designated. There are three answers to this. One, that the provision for penalties may be directed towards the intent at the

time of the issuance of the paper, two, that inasmuch as it is necessary, in order to carry out the true purposes of the law, that commodities or their avails should actually be back of the rediscounted paper, merchants, manufacturers, etc., should be required to limit their use of paper of this character to the strict application to the purposes therein set forth, and should make a division of their funds and accounts accordingly, because, three, they can borrow for other legitimate purposes without making the representations required

The subject of the exercise by the Federal Reserve Board of the functions of a clearing house for Federal reserve banks, and the exercise of like functions by the Federal reserve banks for their member banks, is one requiring careful study. The practical questions that enter into its solution are manifold. The necessity for prompt notice of dishonor or repudiated items in order that the parties interested may not suffer by delay, the tremendous amount of business cleared every day, and the fact that many State institutions are not and may never become members of the Federal reserve system, point to the necessity of the retention of the existing local clearing houses. Whether or not in the future conditions should so change that these institutions could be made departments of the Federal reserve banks is something that must await developments for its determination.

Very truly yours,

ALBERT H. WIGGIN,
Chairman, Clearing House Committee,
New York Clearing House Association

CHAPTER XLIII

THE TRADE ACCEPTANCE

Problem of Trade Acceptance

As has been seen in connection with the history of the Federal Reserve Act, the question had arisen in the process of framing the measure whether it would be feasible to confine the eligibility of paper entirely to single-name notes or whether it should be limited to double-name paper, or whether both should be made technically available as a basis for discount. The question was in a certain sense academic because in the United States, as was well known, the process of bank development had resulted in a great preponderance of single-name over double-name paper, yet in foreign countries central banking practice still depended in a very high degree upon double-name paper and this class of paper constituted the principal staple of trade in the open discount market in most European countries. The question was, therefore, well worthy of consideration in connection with the drafting of so important a statute as the Federal Reserve Act. As will be remembered, however, the attention then given to it had resulted in establishing the eligibility of both classes of paper, although it had been provided that in the open market only the two-name variety should be eligible for purchase and sale. The substance of the provision then amounted to this: That whereas member banks might bring to, and discount with, reserve banks as much single-name paper as they chose, the reserve banks could deal in the open market only in two-name paper.

Not only this discrimination, but some other incidental provisions of the Reserve Act here and there had stimulated in sundry minds the belief that the Federal Reserve Act had

intended to discriminate in behalf of two-name paper. This impression became so strong that various commercial bodies early sought to petition the Federal Reserve Board against any such discrimination, while at the same time there was much discussion among members of the Board itself shortly after organization regarding the position properly to be taken as to the discounting of two-name paper and the attempt to develop such paper. This discussion, as we have already seen, had culminated in the determination to recognize single-name paper as a fundamental element in the business of the reserve banks, and this determination in its turn had resulted in the issuance of "old circular No 13" with its subsequent modifications. But the question of two-name paper remained to be settled and the Board accordingly found itself facing the problem of drafting a circular on the subject at the close of the year 1914.

Principles of Two-Name Paper

The first effort made by the Board was, as usual, that of orienting itself with regard to the general principles of the subject. Fundamentally it had recognized in the case of single-name paper the desirability of having such paper based upon a satisfactory credit statement to be furnished by the customer. In the case of two-name paper the presupposition was that, inasmuch as the paper itself was supposed to grow out of an individual shipment of goods, it would be possible to relax in some measure the requirements relative to the credit statement. The Board's early discussions were, therefore, directed largely to the question of actual practice in connection with the trade acceptances as well as to the ascertainment of the proper principles to be adopted in connection therewith. The point of view attained eventually was reflected in the definition given to the two-name paper, the Board defining it, in Regulation P, issued in 1915, as a trade acceptance or a "bill of exchange," issued or drawn for the purpose of liquidating a bona fide commercial transaction.

In view of the fact that the paper was supposed to follow and grow out of a bona fide commercial transaction and in some cases perhaps to constitute a lien upon the goods through bill of lading, it was the apparent view of the Board that the statements of the kind required in the case of single-name paper would not be necessary. The regulation or circular on this subject, therefore, adopted a considerably more liberal point of view with respect to the trade acceptance than that which had been adopted as regards the single-name paper. As to whether this relaxation was or was not wise, opinion will necessarily differ; but subsequent events appeared to show that there was no reason for the adoption of a more liberal point of view with regard to one than there was with respect to the other. In order to follow subsequent events, however, it is necessary at this point to devote a rather more detailed analysis to the trade acceptance circular as originally issued.

Discrimination in Rates

The general thought in the trade acceptance circular as originally issued was that of making a discrimination in favor of two-name paper, which should result in encouraging the drawing of bills growing out of ordinary transactions in the form of drafts upon the customer. Inasmuch as such drafts would then have (when accepted) the name of the seller of the goods as drawer of the draft and the name of the buyer as acceptor, the theory of the Board was that such paper could be regarded as unusually choice. With the paper having this especially choice quality, the Board, it was argued, would be warranted in making an especially low rate on such paper, designed to facilitate its discount, and thus it was believed the effect of this new type of paper would be that of shifting a good deal of old single-name transactions into the form of double-name drafts.

Accordingly, the trade acceptance circular in its original form held out certain distinct inducements to business men

which it was believed might assist in bringing about this shift of practice. The circular question permitted trade acceptances to be discounted without the filing of credit statements on the part of makers—this upon the theory that the bona fide transaction which gave rise to the acceptance was sufficient to warrant the smaller investigation into the credit standing of the maker or acceptor. A second advantage, or concession made by the Board, was found in the granting of permission to discount such acceptances prior to their being accepted, although in this case the filing of the credit statement was actually required. No limit was placed upon the amount of trade acceptances thus to be discounted, but it was pointed out at the same time through opinions of counsel that paper of this description was in reality to be classed as paper drawn against actual existing value under Section 5200 of the National Banking Act, so that in fact it would be possible to discount trade acceptances without let or hindrance up to as large an amount as the discounting bank saw fit to take and without reference to the capitalization of the maker. Coupling these very substantial advantages from the standpoint of discount with the implied promise shortly fulfilled to make a discriminating rate in favor of trade acceptances, the Board had undoubtedly gone as far as it could legitimately be expected to go in developing a circular which it was thought would appeal strongly to the general public.

Difficulties of Acceptance

All this had been done in perfect good faith but unfortunately with a lack of due allowance for the stability of commercial practice. Singular as it may seem, it would appear that comparatively few, if any, persons subsequent to the adoption of the Federal Reserve Act had foreseen the real trouble which was likely to develop from the effort to introduce two-name paper on a large scale in the United States. It

is true that some of the business associations which addressed the Board on the subject expressed themselves more or less to the point, but there was a lack of cogency and a failure to put the emphasis upon the really significant arguments of the case which undoubtedly deprived them of a great deal of their force. As soon, however, as the acceptance circular had become definitely public the question was raised as to the form to be taken by such acceptances and as to the conditions under which they could be discounted. The Board's counsel had already defined an acceptance as a draft drawn for a "sum certain" expressed in dollars, and this obviously meant that the amount of the acceptance must be fixed at the time when it was drawn.

American practice in business had, however, developed customs of extreme rigidity which would not allow the use of the acceptance in this way. In nearly every line it had become the practice to fix what were called "terms of sale," the essence of which was the establishment of a substantial discount for prompt payment, while the nominal price was to be charged for deferred payment. If, for example, A shipped a consignment of men's hats from Rochester, New York, to New York City, it would be with the understanding that a check sent upon receipt of the invoice might be drawn for face of the invoice, say \$100, less a cash discount, or discount for cash, which varied in amount according to the customs of the trade from 2 per cent up to as high as 6 or 8 per cent. It would be the understanding at the same time that if the buyer of the hats should so elect, he might defer payment for 60 days and at the end of that time might transmit a check for the whole \$100. In practice many firms, in order to retain their customers, were frequently in the habit of extending the allowance of time even beyond the 60 or 90 days originally fixed, in order to meet the convenience or needs of a customer in temporarily straitened circumstances. Inasmuch as the

seller of the goods could not know at the time of drawing his draft whether it was the intention of his customer to take a cash discount or not, he could not specify the sum to be paid in the body of the draft, while, on the other hand, it speedily appeared that the majority of strong customers insisted upon getting their cash discounts as they had done in the past, feeling that they could not afford to take the time allowed to them at the high rates of interest represented by those discounts. It is clear that a discount of even 2 per cent for 60 days represents in theory at least a total rate of interest of 12 per cent for a year, assuming of course that the concern has a turnover that warrants the steady purchasing and employment of goods throughout the year. Both because of the saving due to cash discounts, therefore, and because of the difficulties in the technique of its use, there was trouble from the outset in persuading customers to employ the trade acceptance in their businesses. The trade acceptance was, moreover, unfortunate in the character of the support which it gained.

Abuse of Paper

Not a few of those who advocated the acceptance seemed to do so on the ground that it could be used as a medium of collection or as a way of compelling reluctant buyers who were overdue to pay their debts. It shortly appeared, therefore, that the trade acceptance was being used by many persons in the same way as the old "draft" had been employed—that is to say, that it was being sent to slow or overdue customers with the request that they fill it out if unable to pay cash. In other cases it appeared that the customers, for instance, of retail establishments, were being given the choice of paying cash in full for their monthly purchases or of accepting a draft due at the end of another month. In this case, of course, the trade acceptance was practically being used to extend the period of credit instead of to shorten it, notwithstanding that such abbre-

viation of the credit period had from the very beginning been the great argument in favor of so-called two-name paper

This affords only a brief account of the difficulties encountered in the introduction of the trade acceptance. They were, as already stated, difficulties which had not been foreseen and which therefore had to be combated as they arose. Unfortunately the Board did not think fit to admit the reality of these difficulties but continued to urge upon the business public the desirability of the trade acceptance as a substitute for existing methods of settlement. The probable effect of this situation was to stimulate a tendency on the part of a good many undesirable borrowers to make trade acceptances and to put into that form transactions which would not otherwise have commanded faith, these acceptances being later in many cases presented to federal reserve banks for discount.

Growth of Poor Credit

The result of the practice was unquestionably that of introducing into the general body of commercial paper of the country a second class, or somewhat undesirable element of paper, whose results could be only that of weakening and impairing the general liquidity of the financial system of the country. The character of the situation thus produced did not become evident at once, but developed itself in the course of time until after the close of the war and the termination of the inflation period all banks began to be subjected to a severe strain, while borrowers who had been making money upon the assumption of a probably permanent increase of prices likewise found themselves in straits and facing great difficulty of liquidation. At the same time the trade acceptance was subjected to severe pressure, with the result that the evils attendant upon its use as a basis of accommodation paper or as a means of collection became evident. This type of borrowing was thus effectually discredited save in those classes of cases in which it had been correctly used in accordance with

the older practice contemplated by those who in the first instance provided for the larger use of two-name paper under the Federal Reserve Act

Slow Recognition of Evils

As already indicated, the development of the existence of these abuses was only very slightly recognized by the Board. Representations at an early date began to be made to it concerning the misconceptions of trade acceptance possibilities that were abroad in the community, but apparently little heed was paid to this kind of presentation. On the contrary, the Board continued to maintain a preferential rate in favor of trade acceptances and in other ways to discriminate in their behalf. An organization known as the National Trade Acceptance Council sprang up with the avowed purpose of urging the use of the trade acceptance and even went so far as to countenance some of the less desirable practices already referred to, such as the use of the acceptance in deferring payments in the retail trade. This organization was eventually superseded by another known as the American Acceptance Council which still exists, but gradually changed the type of its work and eventually concentrated its attention upon the improvement of conditions in the use of bankers' acceptances, particularly in foreign trade. To bring about this development, however, required years and during the early period now under consideration no such progress was made, but the community was encouraged to believe that the general use of trade acceptances would be beneficial to business practice. As to this notion so stated there could perhaps be but little doubt, yet the case was very different when it was recalled that the trade acceptance, whose use was thus being urged, was of a very different nature from the similar document employed as a commercial bill in Great Britain or in earlier American practice

Limited Use of Trade Acceptance

Perhaps the best thing about the trade acceptance situation—certainly the one which operated as a saving factor in the Board's earlier experience—was the fact that so little of the paper ever got into reserve banks. Why this limitation should have occurred is not altogether easy to say, but possibly the most cogent factor was found in the existence of rigid trade practices, which prevented the growth of the acceptance movement in its early stages and until it came to be much better understood. On the other hand, the banks in many cases, although doing lip service to the trade acceptance, were not inclined to commit themselves very heavily in the paper when they found, as was usually the case, that the owner of the name on the bill was not very satisfactory from a credit standpoint. Thus while it eventually proved to be true that heavy losses were incurred by banks as a result of inadequate credit information as to the names upon trade acceptances, it may reasonably be questioned whether many banks lost more heavily as a result of such failure as they did through similar failure to study the names upon single-name paper which came to them. The truth of the matter is that there was no reason to believe that two-name paper was better than one-name paper unless credit study revealed a superior credit character in one or both of the names on the acceptance. The fact that American practice did not on the whole call for the documenting of bills, so that acceptances were merely sent by mail while the goods were directly consigned, made the trade acceptance nothing more than a "naked" or undocumented piece of paper, and as such entitled to no better standing than that of single-name paper since it gave no closer or superior lien upon the goods themselves. The fiction that it might be expected to exert a stronger "psychological" influence upon the acceptor may have had some force so long as the trade acceptance was a novel form of instrument, but so soon as familiarity had bred

contempt the force of this influence, whatever it was, disappeared

Subsequent History of Trade Acceptance

Reference will be made at another point to the subsequent history of the trade acceptance in connection with the Board's later discount policy. It is enough to say at the present moment that the trade acceptance, like all other commercial paper, received at the opening of the war a severe blow. There was a tendency to gradual abandonment of ordinary types of financing business, and as the government gradually usurped the entire business field, more and more of the transactions of business came to be founded in one way or another upon some government obligation. This made the steady development of commercial paper during the war practically impossible, or at all events held it down to a minimum. It, on the other hand, prevented the development of undesirable types of paper and in effect deferred the trade acceptance controversy in any active form until after the close of the struggle. At that time, as will later appear, the Board, in gradually working out from the slough of government financing, came to the opinion that it would be better not to retain so complicated a structure of discount rates as had previously prevailed. Eventually, therefore, it abandoned the discrimination in favor of the trade acceptance, putting that instrument upon a basis of uniformity with other like paper. When this had been done the last vestige of the claim that the trade acceptance was in some way superior to good single-name paper had disappeared, and there was no longer very much basis for the propaganda in its favor. Such propaganda accordingly was slackened after the Board had thus decidedly withdrawn its support, and although the Board steadily continued to recognize the trade acceptance as an independent type of paper, to defend it in its circulars, and to warrant more or less discussion about it, the attitude during the post-war period on the whole accept-

ance question assumed a new phase in which the trade acceptance as such figured but slightly

Some Conclusions

While the Federal Reserve Board has been greatly blamed for its work in connection with trade acceptances, there were mitigating factors which tended broadly to modify any such point of view. The Board undoubtedly followed in its trade acceptance policy ideas which had been rather distinctly adopted in the Federal Reserve Act. To the act, therefore, must be assigned the blame, if such it be, for having brought to the front a policy which could not be regarded as likely to become especially successful in view of the character of American business practice at the time. Such blame as attaches to the Board must, therefore, be ascribed to its action in continuing the trade acceptance propaganda long after it had become clear that the instrument was being used in improper ways primarily for the purpose of further extending or aiding in the collection of doubtful debts. Refusal to admit this state of affairs, and continued maintenance of the preferential rate in favor of trade acceptance, was partly the outcome of war finance with its effect in diverting the attention of the Board, as it did, largely from the scientific side of its work. The blame for failure to make a change in policy must be partly ascribed to the natural reluctance of human beings to admit error, and to the fact that a comparatively limited development of trade acceptances in reserve banks had stimulated the belief that no serious harm was being done and that it would be well to afford a rather longer period of trial in order to ascertain whether the paper might not overcome some of the difficulties growing out of long-established and stereotyped practice adverse to its use.

The eventual decision to surrender the trade acceptance propaganda was perhaps partly due to alterations in the personnel of the Board itself, but more largely to a growing con-

viction of the fact that the original undertaking had been unwise. Inasmuch as the matter was one which could be readily controlled by regulation, there was never any sound reason for asking Congress for a new enactment on the subject. Although later experience clearly showed that extensive legislation on commercial paper was to be desired, there was no more reason for dealing with the trade acceptance than for taking up other phases of the problem for special attention. In the main, too, it must be admitted that the policy of the Board accordingly came to be more and more lax with respect to bankers' acceptances, just as it became more and more conservative with respect to trade acceptances. Yet it would have been an ungraceful confession had the Board asked Congress to rectify existing faults with respect to the trade paper at the very time when errors growing out of the misuse of bank paper were being allowed to make headway and to attain a growth which occasionally seemed likely to jeopardize the soundness of some of the reserve banks.

APPENDIX TO CHAPTER XLIII

The facts as to trade acceptances were summarized by the author for the Federal Reserve Board in 1918 as follows:

REPORT ON TRADE ACCEPTANCES SUBMITTED TO FEDERAL RESERVE BOARD

The term *trade acceptance*, so far as can be ascertained, is peculiar to this country and has not been in use abroad. The Federal Reserve Act makes provision for the discounting of notes, drafts and bills of exchange under specified conditions, and although it makes special provision for discounting and trading in bankers' acceptances it nowhere undertakes to differentiate sharply between bankers' acceptances and acceptances of merchants from any standpoint of definition or principle. It was left for the Federal Reserve Board to define and regulate the conditions under which the use of acceptances of both classes might be undertaken and continued. This the Board did in Regulations B and S, issued in 1915, in which it defined the trade acceptance as "a bill of exchange issued or drawn for the purpose of liquidating a bona fide commercial transaction."

The trade acceptance did not receive immediate attention from

the business community, but active discussion of it set in during the year 1916. In 1917, the so-called Trade Acceptance Council, consisting of representatives of commercial organizations, was formed. Discount institutions for the purpose of trading or operating in acceptances were taken under consideration in 1917, and during 1918 some two or three such institutions were established.

Trade acceptances, for a good while after the formulation of the Board's regulations, were taken only very sparingly by the banks, partly because of the practice of owners of acceptances in holding them without discounting, and partly because of the greater familiarity of the banks with the straight single-name note. For the same reasons, such trade acceptances were presented only very sparingly to Federal Reserve banks and but few of them were discounted there. The following table shows the actual amounts of discounted trade acceptances held by the Federal Reserve banks during the years 1914-18. Bankers' acceptances purchased and discounted, also trade acceptances in the foreign and domestic trade purchased and discounted by the Federal Reserve Banks by months during 1915, 1916, 1917 and 1918.

In considering these figures it should be borne in mind that a very large proportion of the acceptances thus discounted with Reserve banks were made as an outgrowth of foreign trade operations and were therefore upon a distinctly different basis inasmuch as in such cases it usually appears that the transaction was carried on under the direct supervision, or in direct consultation or communication with, banking institutions.

The relatively slow growth of the trade acceptance up to a comparatively recent period has led to much discussion of its relative merits and disadvantages, and there is now a large literature on the subject, much of it of a fugitive character and difficult to obtain.

Little of the literature on the subject is of scientific character, the bulk of it being dogmatic in tone and unscientific in method. It was therefore early thought best to obtain all possible results of direct inquiries made into the use of the trade acceptances by their users. The results of these inquiries are accordingly presented as follows:

- I Federal Reserve Board inquiry of 1917
- II Inquiry of Federal Reserve Agents in 1916-1918
- III Inquiry of National Association of Credit Men, 1916-1918
- IV Inquiry of National Trade Acceptance Council, 1917-1918
- V Inquiry of Business Bourse
- VI Inquiry of W. W. Wilmet of the Trade Acceptance Journal, 1918
- VII Inquiry of Messrs. Paine and Jenks of Philadelphia, 1917-1918
- VIII Inquiry of National Association of Manufacturers
- IX Inquiry of Division of Analysis and Research, October-December, 1918

THE TRADE ACCEPTANCE

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(ooo's omitted)

Years and Months	Bankers' Acceptances Purchased	Bankers' Acceptances Discounted	Trade Acceptances Purchased		Total	Trade Acceptances Discounted		Total
			In foreign trade	In domestic trade		In foreign trade	In domestic trade	
1915								
January								
February	2,666							
March	8,356							
April	4,018							
May	2,865							
June	4,701							
July	5,986							
August	4,656							
September	4,548							320
October	6,340							629
November	7,919							496
December	12,759				31			514
Total	64,814				31			1,959
1916								
January	9,453				149			444
February	11,595				522			246
March	22,394				524			299
April	17,566				934			240
May	20,991				921			289
June	39,640				2,685			276
July	34,802				1,773			199
August	27,075				1,371			245
September	31,871				1,212			594
October	39,196				1,699			415
November	45,929				2,618			853
December	64,946				1,925			1,103
Total	360,762				16,333			5,212
1917								
January	20,376				241			574
February	68,994				1,646			856
March	27,476				677			763
April	41,019				294			678
May	79,356				3,189			1,768
June	132,482				2,748			2,521
July	63,629				3,235			1,077
August	67,511				4,612			1,668
September	104,163				4,884			1,126
October	85,443				1,451			4,355
November	181,872				4,346			6,960
December	174,444				3,625			15,425
Total	1,046,765				30,948			37,771
1918								
January	138,528	4,489			2,560			13,462
February	103,262	3,283			2,537	10,230	10,248	20,478
March	206,156	2,996	983	3,561	4,544	3,419	12,313	15,732
April	113,532	1,554	3,822	161	3,983	221	9,950	10,171
May	121,770		7,158	7	7,165	2,708	13,594	16,302
June	88,836		4,625		4,625	3,702	11,935	15,637
July	117,992		5,000	582	5,582	563	13,712	14,275
August	155,016		6,134	1,646	7,780	1,794	11,774	13,568
September	178,887	6,548	3,444	801	4,245	7,866	13,337	21,203
October	258,141	1,070	4,763	2,616	7,379	4,619	19,517	24,136
November	202,246	900	3,706	755	4,461	2,571	13,742	16,313
December								
Total								

1 Data available on hand after January 1, 1918, only

2 No segregation made until March, 1918

3 No segregation made until February, 1918

I TRADE ACCEPTANCE INQUIRY OF 1917

Numerous inquiries received during the early part of 1917 led the Federal Reserve Board in June of that year to authorize an informal inquiry into the conditions under which the trade acceptance was then being used, and the Secretary of the Board was instructed to take the matter in hand. On July 3rd he sent out a letter, previously approved by the authorities of the Board, to each Federal Reserve bank, as follows:

"It is desired to send a letter of inquiry to a small number of representative banks, and an equal number of representative business men placing before each group appropriate questions with reference to the use of trade acceptance. This is for the purpose of obtaining data for use in connection with the work the Board is now doing with reference to commercial paper. Will you, in order to further this work, be kind enough to transmit to the Board at your early convenience:

- (1) A list of about fifty member or non-member banks in your district, divided about equally between large city banks, banks in places of moderate size, and country banks, selecting in each case those that are representative and likely to furnish good information.
- (2) A list of fifty representative business men in your district divided about evenly between manufacturers, jobbers or wholesalers, and retailers, each separately classified. These names should be those of representative concerns, selected without any reference to whether they are or are not known to be employing the trade acceptance and chosen simply as active representative concerns. It would be well to furnish names identified with the various sections and industries of the district as far as possible."

Reserve banks in furnishing the lists called for in the letter above quoted, supplied the basis for the investigation, and the Board thereupon sent to each of the bankers whose names had been sent by the Federal Reserve banks the following letter:

"This letter is being sent to a limited number of bank officers in order to ascertain the present position of the trade acceptance as an element in the commercial paper of the country, the Federal Reserve Board would consider it a favor if you would reply briefly to the following questions answers to which are desired for its information:

- (1) How many and what proportion of your jobbing and manufacturing customers are now requesting those to whom they sell goods to sign trade acceptances?
- (2) How many of these included under (1) are also giving trade acceptances to those or whom they buy?
- (3) How many or what proportion of those included under (1) and (2) are in the habit of discounting trade acceptances with you?

- (4) What rates, if any, were in effect by your bank on July 2, 1917, for the discount of trade acceptances?
- (5) Is your rate for such trade acceptances lower than the rate you would charge in discounting the direct note of the concern offering you such acceptances? If so, how much lower?
- (6) Would you grant a greater aggregate line of accommodation to the concern offering you trade acceptances than you would to the same concern on its own direct obligation accompanied by a satisfactory statement of condition? If so, how much larger (in percentages)?
- (7) What can be done by the Board or by others to encourage the use of the trade acceptance?

"Enclosed is a copy of the Board's Regulations for 1917 on page 6 of which will be found the definition now in force with regard to trade acceptances"

To each of the business concerns whose names had been furnished by the Federal Reserve banks, the following letter was transmitted

"This letter is being sent to a limited number of business men

"In order to ascertain the present position of the trade acceptances as an element in the commercial paper of the country, the Federal Reserve Board would consider it a favor if you would reply briefly to the following questions, answers to which are desired for its information

- (1) Do you at present ask your customers to give you trade acceptances for goods bought from you?
- (2) Do you at present give trade acceptances when you buy goods?
- (3) Do you find that the trade acceptances furnished you by customers are more promptly paid than open accounts (with or without "cash discount") for like amounts?
- (4) Do you discount trade acceptances at your bank, and if so, what rate is charged you? Is this less than the rate on your straight paper? If so, how much?
- (5) Does your banker give you a larger aggregate line on trade acceptances than on your straight paper? If so, how much larger (in percentages)?
- (6) What can be done by the Board or by others to encourage the use of the trade acceptance?

"Enclosed is a copy of the Board's regulations for 1917, on page 6 of which will be found the definition now in force with regard to trade acceptances"

PROPORTION OF REPLIES

Replies were received from 368 of the bankers and 385 of the business houses thus addressed, and additional information was secured from certain Federal Reserve banks, which for some months pursued special inquiries with reference to the use of the trade acceptance, and from mercantile associations, as well as from independent investigators, who had placed their information at the service of the Board

Prof. E. A. Saliers, of Yale University, who had inquired into the accounting aspects of the trade acceptance, loaned to the Board the results of his investigations.

REPLIES OF BANKS

As just stated, 368 replies were received from the banks to whom letters of inquiry were sent. The letters, after being read, were classified, and 126 set aside as furnishing either no information or so little as to render them unavailable for purposes of compilation. This left 242 communications whose authors were able to furnish some information in regard to the inquiry. Of the 242 letters received from bankers, only 26 afforded actual numbers or percentages of customers using the acceptance. The letters thus chosen because of the information they contained were then analyzed. The results of the analysis of the letters received from banks and bankers were as follows:

- (1) How many and what proportion of your jobbing and manufacturing customers are now requesting those to whom they sell goods to sign trade acceptances?

In the large majority of cases answers to this question stated that the number of the bank's clients who requested customers to whom they sold to furnish trade acceptances was negligible, or that in so far as they were aware none were making such a request. In some cases interest was expressed or the statement made that they had been informed of probable action by customers with reference to trade acceptances at some time in the future.

Of the 65 letters which made definite answers regarding the number of concerns requiring customers to furnish trade acceptances there were only half a dozen which reported a greater number of concerns than 6 who were making this request. Many institutions reported only 1, 2, or 3 clients as requesting acceptances.

The proportion of clients making such requests to the total varied somewhat owing to the fact that where bank's clientele was chiefly engaged in retail trade so that but few jobbing or manufacturing clients existed, a very small number asking for acceptances might be a relatively large percentage of the total. One large institution reported nearly 9%, while a few estimated the percentage of 5% or 6%, or less. Smaller institutions occasionally reported higher figures.

- (2) How many of those included under (1) are also giving trade acceptances to those of whom they buy?

The proportion of concerns among the clients of the banks who

reported that they were in the habit of giving trade acceptances for merchandise purchased by them appeared to be negligible, although some expressed willingness to give acceptances if asked to do so. Of those concerns which were asking their customers to furnish acceptances practically none were known to be giving trade acceptances to those of whom they purchased. The answers made it evident that in those cases where trade acceptances had been "adopted" by a business house, such adoption was not, in the opinion of the bank making the inquiry, based upon so strong a belief in the acceptance as to lead the concern to use it in its own purchases as well as in its sales. Briefly stated, therefore, the bank responses to the query as to the extent of the use of the trade acceptances showed such was limited, and in most cases confined by the manufacturer and jobber to the selling side of his business instead of being extended to the buying side.

- (3) How many or what proportion of those included under (1) and (2) are in the habit of discounting trade acceptances with you?

In answering the third question regarding the proportion of users of trade acceptances who were in the habit of discounting acceptances received by them at the bank, the replying institutions were almost unanimous that those who obtained the acceptances discounted them to a greater or less degree, but were unable, usually, to give definite numerical data. It is a fair inference from the statements made, therefore, that in the majority of cases where acceptances were being required, the action was taken with a distinct view to presenting the paper for discount at the bank. This, of course, was not unanimously stated. A number of institutions thought one-half of the concerns which were asking for trade acceptances had offered them for discount. Apparently, however, most of those who were not actually discounting the acceptances had obtained them with a view to possible discount necessities and were expecting to present them in case of necessity. The generalization may be made, therefore, that the request for trade acceptances, when made, appears to have a close relationship to the credit policy of the business house, and its relation with the local bank.

- (4) What rates, if any, were in effect by your bank on July 2, 1917, for the discount of trade acceptances?

Replies to question No. 4 generally stated that no specified rate was in effect on that date named, but that owing to the comparative

scarcity of acceptance paper it was deemed best to treat each case on its merits.

- (5) Is your rate for such trade acceptances lower than the rate you would charge in discounting the direct note of the concern offering you such acceptances? If so, how much lower?

In answering the fifth question, analysis of 148 replies furnishing information on this point shows that in 70 cases a lower rate was made on trade acceptances while in 80 the rate was the same as for the discount of the direct note of the concern. In examining these figures it should be borne in mind that there are included a large number of cases in which banks expressly stated that the rate was purely provisional or theoretical—that is to say that no acceptances had been offered them and none discounted, but that should any be offered, the policy of the bank would be to make a rate that was lower than or identical with the rate on the straight note. The preferential advantage thus actually allowed or to be allowed in the 70 cases where the policy of the institution admitted a lower rate on the acceptance usually varied from $\frac{1}{4}\%$ to 1%. In a very few instances a larger differential than this was specified, but in those cases it usually appeared that no acceptances were being offered and that the preferential rate was therefore theoretical.

- (6) Would you grant a greater aggregate line of accommodation to the concern offering you trade acceptances than you would to the same concern on its direct obligation accompanied by a satisfactory statement of conditions? If so, how much larger (in percentages)?

In reply to the sixth question 167 letters were analyzed. In 153 cases it was stated that a larger line would be granted and in 15 cases it was stated that the line granted would be the same as on straight paper of the concern seeking the accommodation. The proportion of increases to be granted for trade acceptances as compared with straight paper varied widely, most of the replies fixing it at from 10% to 100%. In a few cases larger increase than 100% were specified. In these replies, as in those to question No. 5 it was noted that the majority of the answers were not based upon actual experience, but merely represented the probable policy of the bank should trade acceptances be offered to it in considerable volume.

REPLIES FROM BUSINESS HOUSES

As already stated, there were received from business houses in answer to the Board's inquiry 385 letters. Letters in which no definite

information was conveyed numbered 182, while those which conveyed more or less definite information as to the policy adopted by the replying concern with reference to trade acceptances numbered 203. Eliminating the 182 letters found to afford no data, attention was confined to the remaining 203. In the main these letters were less complete and furnished less analysis of the elements of the acceptance question than did those received from the banks.

(1) Do you at present ask your customers to give you trade acceptances for goods bought from you?

(2) Do you at present give trade acceptances when you buy goods?

In answering the Board's first question, 8 concerns stated that they do at present ask their customers to give trade acceptances, while 11 stated that they were in the habit of giving such acceptances. 141 stated that the concern making the reply was not in the habit of asking for acceptances and 176 stated that they were not in the habit of giving them.

It is to be noted that very few concerns stated that they were both asking and giving trade acceptances, those who reported that they were in the habit of giving them not being in all cases included in the number reporting that they made a practice of asking for such acceptances. In the same way the concerns who were not in the habit of furnishing acceptances were more numerous than those who were not in the habit of asking for them. No uniform practice on the subject existed, but so far as could be deduced from the replies it was the prevailing custom among those who were inclined to the use of the acceptances to request it of customers but not to offer it themselves to creditors. In most cases the statement was distinctly made that the concern making the answer preferred to discount its bills and pay cash, either being in position to do so by reason of its possession of sufficient balances or preferring to borrow on its straight paper at its own bank and remit to creditors for the face of invoices less discount. In a considerable number of the 45 cases in which trade acceptances were asked, it appeared that the acceptances were not habitually asked of all customers, but that in most cases they were requested from concerns which were slow in payment. Practically all of those who reported themselves as making a practice of asking for acceptances inserted the qualification that the request was application only to customers who were not in the habit of taking their discounts, the preferred method of settlement being remittance within a specified number of days for the face of the invoice, less cash discount. In a

number of cases it was reported that the acceptance could not be requested either of those who were in the habit of taking discounts or of settling in full at the expiration of the usual credit period, because such a request would not be favorably received or give offense, so that the request for acceptances was, according to them, necessarily confined to customers who were either slow or doubtful. While in a few instances business houses expressly stated that they would prefer the acceptance system as such for the use of all customers except those who take cash discounts, the majority believed it impracticable to ask acceptances of those who in the past had paid their indebtedness upon the due dates.

- (3) Do you find that the trade acceptances furnished you by customers are more promptly paid than open accounts (with or without "cash discount") for like accounts?

In answer to the third question only 55 replies were made. Of these 51 expressed the opinion, either based upon experience or opinion (in a majority of cases the latter) that the trade acceptance would be paid more promptly than the open account whose place it took. 4 concerns replied that their experience showed that there was no gain in promptness.

- (4) Do you discount trade acceptances at your bank, and if so, what rate is charged you? Is this less than the rate on your straight paper? If so, how much?

On these points 22 concerns replied that they were in the habit of discounting acceptances received by them, while 22 held them in their safes until maturity without presenting them to their banks. 31 concerns stated their opinion with reference to the rates charged or to be charged by their banks, 23 stating either as the result of experience or information obtained from bankers that the rate on acceptances presented by them would be the same as on straight paper, while 8 others either received or had been promised a lower rate.

- (5) Does your banker give you a larger aggregate line on trade acceptances than on your straight paper? If so, how much larger (in percentages)?

14 concerns made answer with respect to the lines of credit to be obtained on trade acceptances, and of these 9 were either receiving or had been promised (usually the latter) a larger line, while 6 had been informed that there would be no difference in the amount of their accommodation. Among the concerns which were not in the habit

of asking or giving trade acceptances, 46 assigned reasons for the credit conditions prevailing in their particular branch of trade, and expressed their views with respect to the question of acceptances in general. Of these 46 concerns 26 stated that they approved of the principle of the acceptance, provided it could be introduced successfully, some asserting that such introduction could be obtained only through joint action by the members of a trade. 20 expressed themselves as strongly opposed to the idea of the trade acceptance on various grounds.

II INQUIRY OF FEDERAL RESERVE AGENTS IN 1916-18

In 1916 a committee of Federal Reserve Agents undertook an inquiry into the extent to which trade acceptances were being used, but the investigation never led to any definite publication of material. The most complete account of what had been done was published in the Federal Reserve Bulletin for January, 1917, where appeared the following statement:

"Your committee believes that there has been a gradually increased use of trade acceptances, but that the movement is not gaining strength in proportion to the opportunities and influence of the Federal Reserve System. While considerable satisfactory work of development and education has been seen in various parts of the country, the efforts so far appear to be scattered and without cooperation, especially among the Federal Reserve Banks.

"The committee has a list of 70 companies who are using trade acceptances with satisfaction. These users of trade acceptances represent 40 different kinds of businesses and are located in 18 States. The largest number of users are dealers in cotton, cotton goods, and cotton mills. The lumber business seems to rank next to the cotton business in the number of concerns using acceptances. While the acceptance plan seems to find a readier reception among concerns of smaller capital, the list is not without a number of names of high rate companies. The information in respect to the number of companies using trade acceptances and the above analysis thereof is based on very incomplete data obtained by inquiry from the Federal Reserve Banks, and in our opinion the list of companies referred to represents only a small proportion of the concerns that have made a beginning in substituting the trade acceptance for the open account."

The committee of Federal Reserve Agents afterwards broadened its functions to include the general question of acceptances from every standpoint, both bankers' and trade. It eventually prepared a statement for publication, such statement being designed for the purpose of educating bankers in the use of both bankers' and trade acceptances and of improving the practice followed in this matter.

III INQUIRY OF NATIONAL ASSOCIATION OF CREDIT MEN

The National Association of Credit Men became interested in the trade acceptance late in the year 1916 and conducted a vigorous propaganda in favor of it during the years 1917-1919. Every effort has been made to obtain from the National Association of Credit Men tabulated or compiled results of its investigation, but no success has been had. At one time the Credit Men's Association forwarded a mass of letters received by the Association from users of trade acceptances and expressing their opinion with reference to the merit of the instrument from various points of view. These letters were never received and it is the opinion of the Association of Credit Men that they must have been lost in the mails or otherwise have gone astray. The views of the National Association of Credit Men have however, been enthusiastically favorable to the trade acceptance from practically every point of view and it would be difficult to name any aspect of the instrument which has not been defended or favorably explained, either in public addresses or written articles by some one representing the Association. This general statement will be amply borne out by a consideration of the Bulletin of the National Association of Credit Men which has steadily carried articles relating to trade acceptances during the past year or two.

IV INQUIRY OF NATIONAL TRADE ACCEPTANCE COUNCIL

The Trade Acceptance Council was an organization formed in October 1917 whose purpose it was to promote the use of trade acceptances. This organization issued a considerable amount of literature urging the use of trade acceptances. Its characteristic line of effort was that of endeavoring to induce organizations of business men to endorse the trade acceptance for employment in their own industries. While the undertaking met with a certain amount of success its efforts did not prove entirely satisfactory either to some of its own members or to certain sections of the public. The organization had been technically formed as a representative of the American Bankers Association, the National Association of Credit Men, and the United States Chamber of Commerce. In the case of at least one of these organizations it has proved impossible to show that participation in the Trade Acceptance Council was ever authorized by the organization. So sharp did the conflict of opinion in the United States Chamber of Commerce become that during the summer of 1918 a special committee was formed for considering the subject of trade acceptances and possibly formulating a referendum to be sent

to all members of the United States Chamber of Commerce, with a view to ascertaining their opinions about the advisability of trade acceptance usage. This committee was unable to reach any agreement and a majority and minority report were formulated, neither of which, it is understood, has ever been made public. They show what very sharp differences of opinion, both with reference to the theory and the practice of the trade acceptance, were encountered in the discussion of the subject. The American Bankers Association, although likewise technically enlisted on the side of trade acceptances, has apparently never given any official endorsement to the Trade Acceptance Council, although an officer of one of its regular committees, Mr. Jerome Thralls, was a member of the Trade Acceptance Council and for several months conducted from the offices of the American Bankers Association a propaganda in favor of the uses of trade acceptances.

Eventually the Trade Acceptance Council seemed to be encountering so many difficulties that it determined to abandon the old type of organization and to establish a new movement upon an independent basis. This was done after a considerable preliminary negotiation, on January 14, 1919, at which time a meeting was held in the offices of the Merchants Association in New York, and a plan for the creation of an acceptance council was formulated.

Early in the work of the Division of Analysis and Research, the National Trade Acceptance Council was communicated with and an effort made to obtain a full account of their activities. The Acceptance Council placed at the disposal of the investigators of the Division its entire file of minutes and also furnished a considerable amount of correspondence and other data. It however stated that its secretary had disappeared, taking with him the bulk of its letters and papers, so that the actual written record of what it had done was more or less fragmentary. The Division, however, gave the work of the Trade Acceptance Council rather careful study and analysis because of the more or less ambitious character of the enterprise and the more systematic way in which it undertook to prosecute its investigations.

While the bulk of the material contained in the minutes [of the Council] related simply to internal operations of the organization, there are from time to time data which have an important bearing upon the attitude of commercial paper brokers and others as to the trade acceptance. This material is so sporadic and scattered that it does not furnish any continuous thread of discussion and it is enough to say at this point that while the commercial paper brokers have been

very desirous of developing the trade acceptance they have found the difficulties in the way very considerable and have been hampered by the following facts

- (1) A disposition on the part of the business community to dispose of trade acceptances at the same time that they were discounting their own paper directly with the banks
- (2) A disposition on the part of a good many concerns to take trade acceptances as an alternative to rather long periods of open credit
- (3) A consequent disinclination on the part of banks to buy freely such trade acceptances and a preference on their part for direct single-name paper

On the whole, the work of the Trade Acceptance Council has succeeded in securing the wider use of the trade acceptance, but in thus broadening the use of the paper it has included many types of paper which are of more than questionable utility. The attitude of leading members of the Trade Acceptance Council in pursuing this method has been set forth in a statement made by Mr J H Tregoe, Secretary of the National Credit Men's Association, prepared at the request of the Division of Analysis and Research for publication in the Federal Reserve Bulletin and printed in the Bulletin for December, 1918. Mr Tregoe says

"Our first motive was to relate merchandise credits more intimately with bank credits, and to help business to get its affairs and methods in such shape that, it could not be taken unawares by untoward happenings, and be subjected to disastrous money strain. We pointed out that this could be best assured to our merchants and manufacturers if they had in hand that class of instruments which are most readily available for rediscount at the Federal Reserve Banks. In other words, we pointed out that American business men had been given a banking system of great potential advantage to them, that the investment preferred above all others under the law creating the system, was true merchandise paper which only our merchants and manufacturers could create. We argued that for their own safety they should make their paper conform to the rules for the most readily eligible paper for purchase and discount at the Federal Reserve Banks.

"We pointed out the advantage that business would get in the formation of an open market for true merchandise paper such as was most readily rediscountable at the Federal Reserve Banks and urged the folly of conducting one's financial arrangements on open-book account and single-name paper upon which open market transactions could not be built.

"Incidentally, we found through the testimony of those of our member concerns who were quickest to see what the Federal Reserve Act had given American business, that the trade acceptance in substitution for the open-book account is a great collection instrument, and that it tends to eliminate abuses which apparently are inherent in the open-book account—abuses which are not only

annoying but exceedingly burdensome, such as the neglect of terms of sale, unreasonable claims, reckless returns, etc

"This secondary reason for the adoption of the acceptance naturally became first in the minds of many business men as they saw in the acceptance a cure-all for costly abuses, and also a means of simplifying collections. The result was that they asked their customers for acceptances not that they might use them for financing their requirements at the bank, but purely for collection purposes, and perhaps these concerns, if they borrowed at all, continued to borrow on single-name paper

"These concerns missed the first great point of the acceptance, but we ask, should the Federal Reserve Banks for this reason lose interest in the acceptance or feel that they should not continue to give it a special position in the rediscount, or give it in other ways their support? In our opinion the Federal Reserve Banks should not change their original policy with reference to the acceptance. The fundamental potential advantage of the acceptance is present in full force as it originally was, true, that advantage has not been so widely appreciated, even by large business concerns, as had been hoped, but through the acceptance, a betterment in our system of high value has taken place, from almost universal testimony we know that mercantile credits have through the trade acceptance, and the agitation for its adoption been greatly improved, are far more liquid and collection troubles have been appreciably lessened

"Through the trade acceptance, the open-book account has been put through a severe test, and its shortcomings have been widely recognized and it is, we feel, but a question of time when we shall have a general substitution of the acceptance method for the open-book account method

"In this progress, we as an association, exerting ourselves for better credit conditions in all phases, are deeply interested. We should think that the Federal Reserve Banks would be no less so, for whatever benefits credit conditions is vitally interesting to them and they should be as patient in treating errors and misunderstandings and even willful abuses which here and there have come up in the adoption of the acceptance method, as we are inclined to be and as they have been unfailingly in the past

"We feel that the Federal Reserve Banks should not lose their interest, even if the trade acceptance were used exclusively as a collection instrument, immediately, and not as an instrument for discount, for the latter step is inevitable as the number of acceptances grows

"The great thing to remember, to our mind, is that the trade acceptance has stirred up more general interest in the whole subject of merchandise and bank credits than anything we have had in this generation. Through the trade acceptance a vast number of people have been put on notice of the existence of the Federal Reserve Banks as live business factors, with which they have a real connection, and the educational work in general has been splendid. That there have been some teachings that have misled is not to be wondered at, but our observation is that the misunderstandings and the erroneous thinking have been coming steadily to the surface and are being corrected."

It will thus be observed that Mr Tregoe admits that there had

been a considerable disposition to use the acceptance as a means for collecting long-standing, and perhaps even somewhat doubtful debts, in other words, to employ it as a collection instrument rather than as a piece of bankable paper or as a means of developing the borrowing and lending methods of the community.

V INQUIRY OF BUSINESS BOURSE

The Business Bourse, a commercial organization with headquarters in New York City, also undertook in 1918 an investigation into the situation as to trade acceptances and obtained information whose value is found in the fact that it was furnished to a concern which had no official standing and might therefore be considered as more unbiased.

On the whole the outcome of the inquiry was favorable, and the statements of the Business Bourse were apparently made with the intent of sustaining and furthering the development of the trade acceptance paper. The arguments presented in favor of trade acceptances are the familiar statements frequently employed in trade acceptance literature, but it was plainly stated that of two hundred individuals with whom correspondence was carried on, only one appeared to be dissatisfied. It was an undeniable fact that many of those who thus expressed themselves favorably to the trade acceptance were evidently using it as a collection instrument, or, as one writer said, "Have used them for five months with customers behind in their account," while another said, "I have found that the time buyer who does not wait to give an acceptance does not intend to pay when the account falls due." Another stated, "Farmers will procrastinate in their payments nine times out of ten, but not when they sign an acceptance."

VI INQUIRY OF W. W. WILMOT

Mr. W. W. Wilmot was formerly in the employ of the National Credit Men's Association at their head office in New York where he had to do with the compilation of data relative to trade acceptances. He subsequently left the National Credit Men's Association and established the Trade Acceptance Journal. In that connection he undertook more or less extensive inquiries into trade acceptances, and in September, 1918, sent out to about 800 persons a letter in which he asked the following questions:

- (A) What is the general attitude of your bank toward the trade acceptance?

- (B) In discounting the trade acceptance at your bank, are you required to maintain a certain credit balance as a condition precedent to discounting?
- (C) Are any additional charges above the discount rate imposed by your bank?
- (D) Has your bank set a limit on the amount of acceptances it will discount for you?
- (E) Does your bank show any disposition to discriminate against trade acceptances for smaller amounts?

About 75 of the replies to these letters were obtained from Mr Wilmot, and were analyzed without special or new results

VII INVESTIGATION OF MESSRS PAINE AND JENKS

Possibly the most extensive and elaborate investigation of commercial credit practices that has been conducted within the past four years is that which has been carried on by George H Paine and John S Jenks, Jr, of Philadelphia. Both are practical business men and devote a very considerable part of their time to the study of economic problems. They have conducted an extensive correspondence with users and non-users of trade acceptances throughout the country and with organizations of various kinds, some of which were friendly to the trade acceptance and others opposed. They have also collected, analyzed and criticized a great mass of trade acceptance literature. The most tangible and concrete result of their studies in this matter has been embodied in an inquiry growing out of a questionnaire sent out on behalf of Messrs Paine and Jenks by Professor John J Sullivan of the Department of Law of the University of Pennsylvania. The replies to this questionnaire have been obtained from Messrs Paine and Jenks and have been analyzed in the Division of Analysis and Research. A consolidated summary of these results, prepared by Mr T A Beal, is as follows:

Professor Sullivan sent out the following four questions

- (1) IN VIEW OF the long established and admittedly sound practice in this country whereby a seller of goods offers the buyer, for prompt payment ("cash"), a premium ("discount") greatly in excess of a bank's interest charge for the full credit period, and
- IN VIEW OF the facilities now offered by the Federal Reserve Banks to enable local banks to finance local merchants in their purchase of commodities needed by the local communities,
- I WOULD ASK —Should we not discourage a practice which requires the seller to bear the burden of financing the buyer, and encourage instead, a practice which will facilitate local bank financing of the local merchants and thus enable the local merchant (the buyer) to take advantage of the premium

("discount") offered by the seller for prompt payment ("cash")?

- (2) IN VIEW OF the fact that the buyer of goods receives, in the quotations and the invoices covering his purchases, a specific offer of a large premium ("discount") for payment within (usually) ten days, and

IN VIEW OF the fact that this premium ("discount") is practically interest at an exceedingly heavy rate, considering the fixed period within which the buyer is pledged to pay,

I WOULD ASK —Should any written promise of payment (regardless of its form) which is signed by a buyer who fails to take the large "cash" premium ("discount"), be deemed such complete evidence of that buyer's ability to pay as to warrant a banker or a seller of goods in largely increasing the amount he would otherwise lend or sell to that buyer?

- (3) IN VIEW OF the offer of a large premium ("discount") usually made by a seller to a buyer for prompt payment ("cash"), and

IN VIEW OF what has been said condemning the "open account" and the commercial credit practice out of which that grew, that is to say, the seller financing the buyer for the credit period at what amounts to an excessive and usurious interest rate, and

IN VIEW OF the rediscount facilities now offered by the Federal Reserve System which enable local banks to finance any sound local merchant in the purchase of commodities for his locality,

I WOULD ASK —Is an open account, or any written promise of payment (regardless of its form), of a buyer who fails to take advantage of the large premium ("discount") offered by a seller for prompt payment ("cash"), a consistently good investment at its face value for a commercial house or a bank?

- (4) IN VIEW OF what has been said in connection with the preceding questions

I WOULD ASK —When a buyer takes up his open account by signing negotiable paper for the amount thereof, which the seller endorses and then gets his bank to discount, does not this mean that the seller is lending his own credit to finance the buyer's purchase of goods, and is not the seller practically an accommodation endorser?

1 About 160 answers were received to the four questions sent out by Professor Sullivan

2 About one-half of the questions are answered by *yes* or *no*

3 The questions are answered *yes* or *no* just about as the author of them would have them answered from the nature of their wording, i.e. they appear to be leading questions formulated and arranged in such a way as to lead the person answering them to give the answer desired, as shown from the great number of similar replies

4 With the exception of a very few, all the concerns answering

Professor Sullivan's questionnaire are in favor of the trade acceptance as compared with the open-book account, but believe that it will require great effort to obtain its general use

5 Many believe that the open-book account is a profitable medium for bad debts and often places the seller in a position where he finds it difficult to cease transactions with the buyer which result in much commercial grief afterwards, but which cannot be avoided at the time, and these particular persons especially think that the trade acceptance would be a great improvement over the open-book account.

6 There are also those who agree to the advantage of the trade acceptance as a desirable form of commercial paper, but believe it would be as hard to change our present credit system as it would be to change the language

7 Again, a number of firms are opposed to the cash discount plan and have even discarded it in certain instances. The Tweed Products Co., St. Louis, the U. S. Envelope Co., the Worcester Salt Co., New York City, believe that cash discounts could be withdrawn and that it is one of the most abused policies now current in business life

8 On the other hand, there are some, who still believe in the old system, as if it were sacred, and think that the seller should carry the buyer. Others, believe that the trade acceptance is a benefit to the jobber and producer but not to the retailer

9 Most of those who are opposed to the open-book account will not admit, however, that failure to take advantage of the cash discount is evidence that the person's note or credit is not good

10 Some other firms do not believe that the seller should be regarded as an accommodation endorser on a trade acceptance or note because of the interest he has in the business transaction

11 The majority of the 160 answers to the questionnaire sent out by Professor Sullivan agree that the buyer should be financed at his own bank, because he is better known there, and not by the seller

12 Fully half of the answers admit that an open account, or any written promise to pay (regardless of its form), of a buyer who fails to take advantage of the large premium discount offered by the seller for cash, is not on its face a good investment for a commercial house or a bank

13 Because of the wording of the questions, fully one-half, also, admit that when the buyer takes up his open account by signing negotiable paper for the amount thereof, which the seller endorses and then gets his bank to discount, is really an accommodation endorser

There has been an attempt to classify to some extent the number

of replies, from whom received, qualified answers to the questions, and direct answers which it is hoped may be of some service, at least in showing the response to the questions sent out. As stated before, however, the questions are somewhat misleading as they doubtless bring the answers desired. The writer does not believe the statements and the implications in the various "In view of's" at the beginning of each question, nor in the conclusions to which they are calculated to lead. In this respect he agrees with Professor Kemmerer's answer to Professor Sullivan. It seems, also, that Mr. Sullivan implies that the trade acceptance is to supplant cash discount, whereas it is aimed more at the open account, also, that he is trying to create a sentiment in favor of the cash discount policy (regardless of its bad features, too, especially in discriminating against the small business man who is struggling to establish himself in business but who is not able to take advantage of the cash discount), and thus to break down any argument in favor of the adoption of the trade acceptance. In other words, he wishes to prove that the excessive practice of cash discounts is sound whether it is or not. In fact, many would not admit that. If business houses would reduce the high rates of cash discount which they now allow, the trade acceptance would not have to be confined so much to the more unfavorable houses and it would soon come in its own as a desirable form of credit to take the place of the open-book account.

Nearly all kinds of business have been considered in the questionnaire as well as the opinions of students of economics, so that it can be said to be quite representative and not one-sided, though perhaps not sufficient numbers have been taken in some instances.

The work of Messrs. Paine and Jenks, however, was, as already indicated, by no means confined to this questionnaire which constituted only a very small part of their studies. In general, the conclusions that they have arrived at appear to be the following:

- (1) The cash discount is an integral part of American business practice, so widely diffused that it may be termed characteristic.
- (2) This cash discount system has a two-fold object
 - (a) Immediate settlement for merchandise through the intervention if necessary of bank credit obtained by the buyer.
 - (b) Full termination, as a result of such settlement, of the seller's liability.
- (3) In order to attain the objects set forth in (2) above, cash discounts have been made heavy or light, corresponding to the value placed by the seller of merchandise upon the attainment of the two

objects referred to. It is, therefore, an indication of credit weakness on the part of the buyer if he does not take advantage of the great reduction in cost which the cash discount offers him. By failing to take advantage of it he tacitly confesses that he cannot obtain credit from his bank for the purpose of conducting his business, but must be financed by the seller of the goods at a usurious rate.

(4) The trade acceptance is not compatible with the cash discount system. It will therefore tend to find its principal field in those transactions where either

- (a) The cash discount system does not exist, or
- (b) The buyer does not care to take advantage of the cash discount.

(5) Inasmuch as the field of trade in which there is no cash discount is very small, this seems to suggest that the trade acceptance is destined to be almost invariably the representative of secondary or second-grade credit.

(6) Experience has shown that the trade acceptance tends to abuses. One of them takes the form of the lengthening of credit terms, in itself an objectionable practice.

(7) The condition in the United States relative to the use of trade acceptances is quite different from that existing in foreign countries, because there the cash discount system is not widely adopted, while on the other hand there acceptances are sold in the open market with the endorsement of an acceptance or discount house. They are not so sold here. The bulk of them are discounted by the seller at his own bank.

VIII. INQUIRY OF DIVISION OF ANALYSIS AND RESEARCH

The Division of Analysis and Research in undertaking a trade acceptance investigation had the advantage of some of the material which had been collected by previous investigators. A preliminary survey was first made and the field of work was divided among those to whom it had been assigned. While they were carrying on the investigative work it was thought best to attempt a brief field investigation designed to cover certain points which had apparently not been fully dealt with in the earlier inquiries. The following set of questions was therefore addressed to about 250 business houses:

- 1 General nature of business?
- 2 Terms of payment customary in your line?
- 3 Estimated percentage of customers taking
 - (a) Cash discount
 - (b) Longer term

- 4 Do any of your customers send you trade acceptances in settlement of accounts?
- 5 If so, kindly answer the following
 - (a) Do any of your cash paying customers ever send trade acceptances?
 - (b) Are the trade acceptances mostly from customers not paying cash?
 - (c) Do you offer any inducement to customers to send you trade acceptances?
 - (d) Do you discount trade acceptances sent to you?
If so, does your bank quote a special rate on trade acceptances?
Will your bank take all that you offer?
Can you obtain from your bank a greater amount of credit with trade acceptances than you can by borrowing directly?
If your answer to the preceding question is *yes*, would you please indicate what your bank's policy is with respect to direct borrowing in combination with trade acceptances?
 - (e) Do your customers who send you trade acceptances ever arrange for the discount of such paper by their local banks?
Kindly indicate the conditions under which this has been done, if ever
 - (f) Have you tried to sell trade acceptances through a broker or in the open market?
If so, kindly indicate what success you have had
 - (g) What percentage is paid at maturity?
What percentage is carried on open account, or otherwise arranged for?
- 6 Kindly send us a blank form of the trade acceptance you employ
- 7 Please state briefly your own opinion of the trade acceptance as an instrument in American business

At the same time, the following set of questions was sent to about 125 banks, geographically distributed throughout the country

- 1 Approximate number of clients offering trade acceptances for discount?
- 2 General lines of business represented?
- 3 Preferential rate, if any, on trade acceptances?
- 4 What limit, if any, do you impose on trade acceptances offered for discount?
- 5 For ten representative clients please give percentage of credit extended
 - (a) On individual notes
 - (b) On trade acceptances
 - (c) On other paper or collateral
- 6 Have you ever bought trade acceptances through a broker or otherwise in open market?
If so, kindly state points emphasized in selection
- 7 Enumerate the factors which, in your judgment, must determine the acceptability of a trade acceptance as an investment for a bank

THE CONCLUSIONS AS TO PRACTICE

On the strength of the replies to these questions and other data, it is possible to state some general conclusions as to facts with reference to the use of the trade acceptance in the United States at present time. These may be summarized as follows:

1 The trade acceptance has obtained a footing with a number of banks and business houses in various parts of the country. In some cases of business terms of payment have been so fixed as the result of custom and conditions in general, or are of such a nature that the trade acceptance is not being used. In other lines of business a market field for it is open and the use of the instrument has made considerable progress.

2 Among those business houses who favor the acceptance many prefer to do so chiefly on the ground that it affords a superior means of collection.

3 There is little evidence to show that a larger line of credit is actually being extended on the basis of trade acceptances than would be given on straight paper. Preferential rates in favor of trade acceptances are being made by few banks in any part of the country. A number of bankers state that they would under proper conditions grant a larger line to a concern working on the trade acceptance basis, such line being variously figured at from 10 to 300 per cent greater than the line to be granted on single-name paper. It appears, however, that the granting of a larger line in this way is likely to be determined by the character of the names of the acceptors. If the acceptors are concerns of high credit the bank is inclined to grant correspondingly larger line than it would to an individual borrower who does not present the customer's acceptance. On the whole, investigation shows that the line is larger only in proportion as the credit of the acceptors is superior to that of the seller who presents acceptance for discount.

4 Practically universally it is desired to maintain the prevailing custom of payment subject to cash discount. Trade acceptances are not regarded as a substitute for the cash discount system, but as merely applicable either to customers who are in the habit of making their full permitted time in which to pay, or to customers who are slow or doubtful.

5 Where the trade acceptance is being used by business houses, these methods of settlement are generally being suggested to customers, as follows:

- (a) The payment of the invoice value of the goods less a cash discount, provided remittance is made within a short period, usually ten days, although sometimes longer
- (b) Settlement for the goods by the transmission of a trade acceptance payable within a specified period, say, 60 days. In some cases such trade acceptance settlement is induced by offering a smaller discount from the invoice value. Thus, if the cash discount is 2%, the trade acceptance may be 1%
- (c) Settlement for the goods without discount from the invoice value at the end of a specified period, during which the goods are carried on "open account"

The firms which place these alternatives before their customers endeavor to encourage immediate remittances with cash discount, or in lieu of this, the use of the trade acceptance. In some cases no concession is made in order to obtain the trade acceptance, but the customer is urged or occasionally required to give the acceptance if he is unwilling or unable to pay within the "cash" period and to take his discount.

6 In most cases where trade acceptances are requested the seller of the goods asks the buyer to mail him direct a trade acceptance. The buyer then accepts the draft and sends it by mail to the seller, who either holds it in his safe or may discount it at his bank.

7 When trade acceptances are discounted by the seller of the goods the banker may or may not grant a preferential rate as compared with the straight single-name paper of the buyer (seller of the goods). Of the banks which responded to the inquiries of the Board some few stated that they were actually granting such a favorable rate, varying from $\frac{1}{2}$ per cent to 1 per cent less than the regular rate, while the others stated that they were not granting any special rate. Other bankers replied that while they had not had any trade acceptances presented to them they might be willing to make a special rate under suitable conditions.

8 Considerable difference of opinion exists among well informed business men and bankers with reference to the benefits of the trade acceptance as a credit instrument.

9 There are a considerable number of practical and technical difficulties involved in the use of the trade acceptance which will have to be overcome if the paper is to be more widely popular.

CHAPTER XLIV

THE BANKERS' ACCEPTANCE

Origin of the Acceptance Issue

One of the issues in the discussion of the Federal Reserve Act which had received great attention in technical quarters but had been only casually observed by the general public, related to the question whether bankers' acceptances should or should not be provided for and used as discountable paper. Under the National Banking Act there had been no provision for the creation of such acceptances. The Aldrich bill which preceded the Federal Reserve Act had, however, made provision for them following after European custom in the matter. The acceptance had been widely developed in Great Britain and it had come to be the frequent practice for large deposit banks to have outstanding amounts varying from 80 to 100 per cent of their capital in the form of acceptances, while acceptance houses, special institutions formed for the purpose of accepting, frequently had ten times or more the amount of their capital outstanding in this form. There had been a growing belief for a long time among American bankers that the National Banking Act had been unwise in prohibiting national institutions from incurring time obligations of this kind, and that a reintroduction of the practice would serve to permit the growth of a genuine discount market in the United States.

When the Federal Reserve Act was up for discussion, the whole question was taken under advisement and was carefully re-examined. Correspondence was carried on with many experts, and the best Canadian authority was also consulted.

The general consensus of opinion thus arrived at was that the bankers' acceptance was an instrument which called for very careful use, if it was to avoid being the servant of inflation and that in order to have it a safe and trustworthy piece of commercial paper it should be used only as the outgrowth of specific transactions. Inasmuch as, under American practice, single-name paper, involving lump-sum borrowing, had superseded the old two-name type of accommodation, it was the best opinion that the bankers' acceptance should be limited to foreign trade, and should be used for the purpose of financing specific individual transactions which called for the shipment of goods out of or into the country. Accordingly, the Federal Reserve Act limited the use of the bankers' acceptance to genuine foreign trade, contemplating the issue of "salt water bills" only, and specifically provided that the total amount of such acceptances to be issued should not exceed 50 per cent of the paid-up unimpaired capital stock of any bank resorting to them. This, however, was soon raised to 100 per cent.¹

Theory of Bankers' Acceptance

A few words concerning the theory of the bankers' acceptance may not be out of place at this point, especially for the use of the non-technical reader. In the bankers' acceptance, the transaction essentially consists of an arrangement whereby the banker undertakes to accept a draft which otherwise would be accepted by a business man engaged in dealings with some other business man. The business man who would otherwise act as acceptor induces the bank to put its name on the draft instead of placing his own name there, because in so doing his creditor is more willing to extend credit. In cases where the seller of goods (or creditor) would refuse to make a sale except for cash funds, he is now induced to extend credit

¹ See Appendix A to this chapter

by reason of the fact that the banker has placed his name on the bill, the feeling being that the direct obligation of a bank of good standing is easily salable to some investor, whether bank or individual, who is looking for a temporary use for his funds which will keep them at work and bring him a small revenue. Hence the possibility of borrowing at very low rates of interest on bankers' acceptances.

Clearly, in order to have this kind of transaction help rather than injure the business and credit structure, it is necessary that it should be very carefully safeguarded, in such a way as to insure that the acceptance should not merely become a means of borrowing for speculative purposes, or to help out hard-pressed banks or individuals, and especially in order not to provide an extension of credit which under ordinary commercial conditions could not be had. To put this in another way, the theory of the bankers' acceptance is that of rendering more liquid or salable credit of an undoubted character which is itself absolutely reliable and ultimately cashable. Harm would come, therefore, if the acceptance were used merely to mask long-term or doubtful credit and thus bring about easy cashing or discounting of bills which in ordinary circumstances could not be cashed or discounted at all at a commercial bank. These principles should be generally borne in mind in studying the acceptance. There was no field of activity in which the efforts of the Board were more disappointing, and none in which the peculiar play of financial forces tending to drive the federal reserve system this way and that became at times more pronounced.

Early Study of Acceptances

The subject of acceptance was taken in hand by the Federal Reserve Board very early after its organization. Indeed, if some members had been allowed to have their way, it probably would have been made the first subject of action, but,

as already seen, the necessity of dealing with commercial paper was so obvious as to necessitate first attention to that subject, and the bankers' acceptance therefore was deferred until after the commercial paper regulation was out of the way. This threw the discussion of the bankers' acceptance back into the early months of 1915, but before the winter was over the Board was spending a substantial part of its time upon the formulation of the acceptance regulation, notwithstanding that at that time, of course, there were not only no acceptances in the market but little indication that any bankers would want to use this type of financing. The questions at issue in the beginning centered very largely around the conditions under which the acceptance should be allowed to be made by banks, and the further question what bankers might make acceptances which would be eligible for purchase by the federal reserve system. On the whole, the latter question was the one which received most attention.

It was plain from the outset that, while it had been very repugnant to bankers that there should be any thought of open-market dealings on the part of federal banks which might bring them into close relations with individual borrowers, there was no such feeling either with respect to possible relations between federal banks and individual bankers or in their capacity as members of the system. Private bankers, too, were looking eagerly to the action of the reserve system on the acceptance question as equivalent to a decision regarding how far they should be allowed to get the benefits of the federal reserve system for themselves. There was a good deal of doubt in the minds of the larger member banks of the cities as to whether or not they could expect to do very much for themselves through the introduction of the acceptance plan. The private bankers had no such doubt, for they knew that a satisfactory acceptance régime at the reserve banks would be equivalent to giving them access to all the

funds that they needed at rates of interest much lower than they could probably command anywhere else ²

Loopholes of Interpretation

The Federal Reserve Act itself had used language which unfortunately had to be broad, and which therefore opened loopholes of interpretation that might easily offer a door to undue advantage for outsiders. Should the federal reserve banks undertake to buy and trade in the acceptances only of their members? Should they broaden the field and take in the acceptances of state banks? Should they go still further

- Although the acceptance regulations of the Board had been issued during the early spring of 1915, they had attracted comparatively little attention and there had been but a small amount of bankers' acceptances offered in the market. The quantity bought and held by the federal reserve banks themselves on July 1 of that year was only ten million dollars. Some discouragement had been expressed not only by members of the Board but also by men of standing in the financial and banking community, because of what they considered to be indifference of the banks with regard to the use of the acceptance. It may be worth while to note at this point that there was no well founded reason for such discouragement inasmuch as the banks had, through the release of reserves at the time when the federal reserve banks were organized, been fully provided with a large surplus lending power. On the other hand, our foreign trade was developing along new and very special lines as the result of the European war. It was no longer necessary to resort to methods of financing this trade to afford credit to foreigners. American manufacturers were in the unique position of being able to name their own terms and of selling only for cash against documents—that is to say, cash in New York prior to the arrival of the goods or credit. In these circumstances a condition less favorable for the development of the acceptance could hardly be imagined, and as a matter of fact it did not take immediate root in commercial practice.

The war, however, had brought with it its own financial problems. Very soon after the opening of hostilities the question had been raised whether belligerent countries could borrow in the United States. This had been unfavorably answered at the outset by the State Department, which held that it was not a proper act for a neutral country to permit the offering of loans within its borders in behalf of the belligerents. The Department, however, hid it about the same time strongly taken the position that the shipment of goods, including munitions of war, to belligerent nations was in no wise to be objected to—a position subsequently expressed in the strongest language in the memorandum on the same subject issued by Secretary Lansing during the late summer of 1915. The Department was thus placed in the ambiguous position of advocating and defending the sale of goods, including munitions, but of holding illegal or undesirable transactions that might have to be sold on credit or paid for out of the proceeds of bonds. Even when this inconsistent position had been decidedly modified, there were difficulties in the way of direct bond issues in the United States and the practice of relying upon American banks for accommodation developed.

The question what form could be given such obligations in order to facilitate purchase on the part of the Allies, had become an urgent matter with a good many banks, and in the search for a means of keeping their portfolios in apparently liquid form while at the same time making fairly long term loans, the question had been raised whether both objects might not be attained through the use of the new power of acceptance. The matter came to a head about the midsummer of 1915 in connection with an application made to the Board by a private banking house in New York City which desired to place on the market bankers' acceptances made for the purpose of supplying the French government with some of its war needs. Without going into the technique of this undertaking, the main outlines of it may be briefly sketched. The underlying thought in the proposal was that of providing about fifty million dollars for a two year period. This sum of money was to be expended in the United States in the purchase of army supplies. As the American shippers furnished the goods they were to draw upon designated members of a group of banks which had been formed into a syndicate for the purpose. These drafts were immediately to be accepted by the bank upon which they were drawn and were as quickly to be discounted at another bank belonging to the syndicate.

and take in the acceptances of "bankers"—meaning thereby any individual or firm engaged in "banking," as interpreted by itself or by the laws of the state under which it was operating? The question was one which was peculiarly local to a very few places, because only in those few had there been much growth of the private banking houses, especially to New York, where they had attained so extensive a scope. Yet the federal reserve system was organized upon a basis of credit study. Much that its framers had urged was based upon the idea of a very careful study of credit. Much that had been said by the Board in the regulations on commercial paper already issued had been based upon the notion of intimate knowledge of credits. Now, could such a Board consistently admit to reserve banks the paper of individuals, firms, or corporations probably in large amounts, merely because they chose to call themselves bankers? The question was one which naturally elicited the greatest doubt on the part of some members of the Board, while others were equally anxious to see it resolved in favor of the broad interpretation, thereby letting the private banking houses in upon the "ground floor" of the system. This contest eventually narrowed to a question whether the private bankers to be included under the regulation would or would not file statements of condition with the federal reserve banks.³

Statements of Condition

There was little or no difference of opinion about the requirement that state banks and trust companies not members of the system and yet desiring to have their acceptances eligible, should be required to file full and complete reports of condition with reserve banks at which their acceptances would be presented. Indeed, the state banks had little or no objection to any such requirement. They were in the habit of being regularly examined and reported upon by state

³Some members of the Board obtained a special report on British banking practice, given in Appendix B to this chapter.

examiners, some of them much more stringent and positive in their requirements than federal examiners. Their operations were closely watched by law and they had but little to conceal. The private bankers, on the other hand, were both anxious to have their acceptances eligible and at the same time to avoid the necessity of filing their statements which presumably would give to reserve banks, and perhaps the Board, data which had never before been thrown open to "outsiders." The discussion raged furiously for a long time, but eventually a compromise was reached whereby it was agreed that private banking houses might file their statements with their local federal reserve bank, there to be kept under lock and key and to be accessible only to the governor and to the federal reserve agent, and even to be secret from the Federal Reserve Board.

The Board thus for a second time found itself drastically defeated since it surrendered its powers, in the control of credit and in what was believed to be one of its most important and fundamental elements, to the governor and federal reserve agent of a local federal reserve bank. The Board even went further than this by providing that it should not be necessary for such a private banker to file with any save his own home federal reserve bank a copy of his statement, but that having filed it with his own federal reserve bank such bank might then certify to other reserve banks that that statement was on file and was satisfactory, whereupon acceptances made by such private banker would be eligible to discount or purchase at all other federal reserve banks. No conspicuous position was given to this statement in the regulations, but in the final form assumed by the acceptance circular it was merely stated that "no Federal Reserve Bank shall purchase the acceptances of a banker other than a member bank which does not bear the endorsement of a member bank unless a Federal Reserve Bank has first secured a satisfactory statement of the final condition of the acceptor in a form to be

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approved by the Federal Reserve Board" This of course left the situation about as 'wide open' as could have been desired.¹

Making the Acceptance a Finance Bill

Up to this point the development of the acceptance, whatever may be thought of it, had proceeded along lines which were strictly within the boundaries of banking principle. The concessions made to the private banking houses in regard to their statements had no necessary bearing upon the working of the acceptance provisions. A question of quite different significance and magnitude was now to present itself. This had to do with the use of the acceptance for the purpose of financing transactions which otherwise could not have been carried by the banks at all, and incidentally of using the resources of federal reserve banks for the purpose of supporting or carrying these transactions. It is probable that the controversy about this question would not have been very long delayed in any case, but as circumstances turned out it was brought to the front as the result of the necessities of the European war. From the beginning of the war, foreign countries and domestic exporters had found conditions in the United States peculiarly favorable, from their standpoint, to the financing of our foreign trade. True, there had been some phases which had tended to interfere more or less with the flow of exports to the belligerent nations. Among these was the action of Secretary of State Bryan in urging that the floating of loans on behalf of belligerent countries in our market should not be undertaken. But in the main the situation had been favorable to the growth of the financing of foreign trade with a special view to the service of belligerents. As the war advanced, however, banks tended to become more

¹ The acceptance regulation went through various forms but finally assumed definitive shape in "Regulation R, Series of 1915" published on September 7, 1915, and reprinted in the Federal Reserve Bulletin on October 1, 1915, page 310. See Appendix C to this chapter. See also Appendix D for history.

and more fully engaged, and the "slack" which had been furnished through the change in reserve requirements came to be more and more fully taken up. This slack was sufficient to render possible a very great volume of financing, yet a time would of course come when it would reach its end. As the necessities of the foreign countries for immediate relief grew more intense, they began to cast about for ways and means of financing their requirements on an economical basis and many came to the conclusion that this could be done, only if access were granted to the funds of the federal reserve system.

French Acceptance Credit

The natural way of getting such access was seen in the development of the acceptance practice which would permit the use of federal reserve bank credit by member banks engaged in such operations. During the months of July and August this situation came to a head as the result of efforts made by a New York private banking house to obtain assurances that its acceptances would be eligible under specified conditions, these conditions providing for an issue of acceptances whose proceeds were to be used for the purpose of financing the export of munitions practically to the French government. The desire of the bankers was to establish an agreement whereunder the banks making the acceptances would agree practically to renew the acceptances from time to time up to a term of about two years, during which the holdings of the paper would be distributed and redistributed among a syndicate group of banks whose function it was to purchase and hold this paper until such time as it could eventually be redeemed. The date of its redemption was intended to be determined by the action and ability of the French government in paying off short-term notes which it had issued. Of these acceptances the proceeds were to be used in paying for the supplies which certain French mer-

chants who negotiated this advance were expecting to obtain from the United States by the use of the funds realized by their sale.

The question whether such paper as this was eligible involved several technical questions, the chief of which may be mentioned as follows:

1. Was it legal for a bank to establish a "line" of acceptances in the same way that it would establish a line of credit, by agreeing to accept up to that amount in favor of any particular customer, or in other words, to keep outstanding a specified amount of acceptances, redeeming them from time to time and issuing others to take their place?
2. Could such acceptances, originally issued against a shipment of goods, be renewed after such goods had gone out of existence through use, notwithstanding that it was frankly admitted that the security or protection originally placed behind the acceptances no longer existed?
3. Was it a "commercial transaction" to sell such goods as explosives to a government which intended to use them in non-productive ways, as, for example, for the purpose of shooting them away against a hostile army?

The basis of these questions with reference to the establishment of a line of credit was fundamentally important, and as to them in their chief aspects, a ruling was obtained by the Federal Reserve Board from its counsel, substantially to the following effect, as was given in an inconspicuous place in the Federal Reserve Bulletin ⁵:

The Federal Reserve Board and the Comptroller of the Currency, at the instance of the Federal Reserve Bank of New York, have considered the question whether a national bank can enter into an agreement under which a line of acceptance credit may be given by such bank, the credit extending for a period of nine months but the individual drafts drawn upon the accepting banks to be

⁵ September, 1915, p. 269

payable at 90 days' sight and not to exceed the total amount specified in the letter of credit, and after referring the question to counsel of the Board for an opinion issued a ruling in substance to the effect that a national bank is authorized to enter into an agreement having more than six months to run, by the terms of which it obligates itself for a period of time specified in the agreement to accept drafts drawn upon it, provided such drafts grow out of transactions involving the importation or exportation of goods and that the individual drafts have not more than six months' sight to run.

The restrictions of section 13 of the Federal reserve act would, of course, limit the total amount of acceptances made by any one bank, including those described, to an amount equal in the aggregate to not more than one-half of the paid-up and unimpaired capital stock and surplus of the member bank, except that by authority of the Federal Reserve Board, under general regulation of the Board, a member bank may accept for an amount not to exceed the amount of its capital stock and surplus.

It should be understood, of course, that the 10 per cent limitation imposed by section 5200 of the United States Revised Statutes is not intended to apply to the mere acceptance of a bill of exchange, but that the provisions of section 5200 of the United States Revised Statutes would apply to the indebtedness arising between the drawer of the bill and the accepting bank in case the drawer fails to furnish funds with which to meet the acceptance at maturity.

It should also be understood that the limitation of six months specified under section 13 of the Federal reserve act applies to the draft but is not construed as applying to the agreement or letter of credit under which the draft is drawn. This limitation of six months does, however, apply to specific drafts drawn under such agreements or letters of credit, and consequently, if the terms of the agreement or letter of credit imposed upon the holder for value of the draft any obligation to renew such draft at maturity so that the original draft with the renewal thereof would remain an obligation of the accepting bank for a period exceeding six months, such agreement would be ultra vires.

The distinction emphasized in connection with this ruling is this. While a letter of credit or credit agreement may lawfully be made by a national bank which will extend by its terms for a period exceeding six months, the agreement must not be of such a character as will impose upon the holders of drafts accepted thereunder any

obligation to renew such drafts so that the period of acceptance shall exceed six months in duration as to any specified draft

Acceptance Issue Sharply Drawn

The issues involved in this opinion of counsel and in the application of the bankers were of such magnitude and significance that a contest in the Board itself was practically inevitable. Such a contest was precipitated in July and August, 1915, when the Board held meetings with officers of the Federal Reserve Bank of New York for the purpose of settling in its own mind whether the Federal Reserve Bank of New York might advise the private bankers already referred to that their acceptances would be eligible. The issue was interesting from a political standpoint, because Treasury officials were of the opinion that a free use of reserve bank credit on this occasion would make it much easier to continue the development of our foreign trade, and they were therefore favorable to such policies as seemed likely to further that end. Impressed as they were with the belief that a favorable reply to the application of the private bankers would enable our goods to go abroad in increasing amount, Secretary McAdoo and Comptroller Williams were disposed to take an attitude quite the reverse of that which they had adopted at earlier times. Whereas on former occasions they had been disposed to be strict constructionists on the question of documentary acceptances, insisting that only those acceptances should be eligible which were representative of specific financial transactions, they now were disposed to adopt the position that acceptances could be used more or less free of the limitations imposed by documentary requirements, provided only that it represented a bona fide export of goods. They were, moreover, disposed to the view that such use of acceptances was to be warranted regardless of the purpose to which the goods were to be applied after exportation had taken place. If the goods consisted of munitions, or even of ammunition, that was a matter to be settled by the buyer.

The question thus raised was finally determined at a meeting held in New York on the 10th of August, 1915, and to which reference has already been made.⁶ After lengthy debate, it was then determined to authorize the eligibility of the acceptance drawn on the revolving plan and thus practically to make the acceptance an accommodation bill drawn without any particular reference to the movement of the goods or the character of the shipment and still less to the real maturity of the obligation—provided only that a reputable bank stood ready to convert an acceptance into cash at the end of the technical 90-day maturity if required to do so. The decision thus taken was

⁶ It had been determined to hold a final session in New York City on the 10th of August. At that time it was suggested that conference might be had with the officers of the Federal Reserve Bank of New York and, if necessary, with the bankers who had been promoting the new acceptance credit. The place of meeting was set at the Subtreasury and on the day appointed an attempt was made to secure the attendance of a majority of the Board at that place.

The proposed session at the Subtreasury, New York, proved unsatisfactory to certain members of the Board who were of the opinion that by holding the meeting at the offices of the Federal Reserve Bank of New York, there would be a more convenient communication with the officers of the bank itself, and better results would be obtained. Accordingly an effort was made to transfer the session to the Federal Reserve Bank of New York, but for some hours the efforts were frustrated by the refusal of other members of the Board to gather there. For a time, therefore, it seemed as if there might be two rival meetings at neither of which a quorum would be present. Late in the day an arrangement was perfected whereby the session was actually called at the Federal Reserve Bank of New York, and a lengthy discussion concerning the eligibility of the acceptance credits referred to then occurred.

It was a notable fact that members of the Board who on previous occasions had been opposed to the adoption of regulations whose effect would be to lengthen the duration of acceptances or to make them practically finance bills, were now inclined to accept the opposite point of view on the ground that the exigencies of war and of our domestic trade in munitions and supplies of all kinds made it necessary to adapt ourselves thereto and to furnish such relief as was possible to banks which otherwise might find themselves deeply involved in paper that was frozen or that represented advances which could not be rediscounted or recovered in any way. The attitude of the representatives of the Federal Reserve Bank of New York was favorable, not only to the proposed acceptance credit which has already been described, but was in general favorable to the making of acceptances without any definite connection between them and the goods which they represented—that is to say, acceptances which at the utmost represented—that a movement of goods that might take place at some time in the future, although there was plain statement from time to time that in order to operate upon the same basis as foreign countries it must be recognized that the acceptance was essentially a finance bill having no connection whatever with any definite movement of goods, although of course based upon the recognition that movements of goods would inevitably occur at the same time in order to equilibrate balances of trade.

The only immediate outcome of the discussion was a vote practically declaring the proposed acceptances eligible, the general theoretical issues being left to take care of themselves at a later date. It was, however, seen that the action taken left the Board in a ridiculous position unless there should be an almost immediate modification of its acceptance regulations. Such a modification was accordingly drafted and shortly thereafter issued under date of September 7 (See Appendix C to this chapter.) The new set of regulations greatly relaxed the requirements of the old regulations with regard to the requirement of documents or the certification that the shipments of goods were to be financed by the use of the acceptance and practically placed the bankers' acceptance upon a much lower footing in so far as strictness or liquidity was concerned. It was not strange therefore, that other credits of the same kind as that which had just been declared eligible should follow one another in rapid succession, and within a few weeks some of the large institutions in New York were issuing such credits and declaring in their circulars that acceptances made under them were eligible.

far-reaching in its significance and probably could not be exaggerated in importance. As a consequence of it a revised edition of the acceptance regulation was almost immediately issued and this reprint was drawn in such a way as to admit the revolving credits and the acceptances growing out of them to eligibility. Thus the federal reserve system had definitely gone shortly after the middle of 1915 into the task of financing the European war. Only a small element of the public, however, realized at the time the actual character of the step which had thus been authorized.

Second Phase of Acceptance Policy

The second phase of the development of the acceptance was begun early in the year 1916. Not a few banks and commercial houses had during the preceding year begun to realize in a very vivid way the enormous advantage which they gained by financing themselves on an acceptance basis. Not only were the rates fixed for acceptances at that time very low, being frequently as little as $2\frac{1}{2}$ per cent, but the acceptance plan insured the marketability of paper and practically guaranteed the financing of any given enterprise upon a basis of clear profit, since the acceptance, if declared eligible, could be transferred direct to the federal reserve bank. Reserve banks at that time, moreover, had but little business and were not disposed to exercise too close a scrutiny of the paper that was offered them.

Accordingly the question arose in many minds as to whether the bankers' acceptance might not be employed to advantage in connection with the financing of commercial transactions. As in the case of exports of munitions and army supplies, the problem was that of giving what was in effect a long-term loan, the appearance of a short-term liquid transaction. The long-term loans desired by commercial concerns were chiefly those which involved the carrying of raw material or stocks on hand, and may be well represented by the case of a large tobacco company whose plan for financing was pre-

sented to the Board upon a basis which involved the selling of short-term acceptances to be protected by stored leaf tobacco. The questions at issue in this matter, although not identical with, were very similar to, those which had been raised in connection with the munitions acceptances already described. They were, in brief, whether goods in storage and not yet sold really constituted the basis for the issuance of bank obligations whose proceeds were to be used for the purpose of carrying the commodity until such time as it should either be disposed of or worked up into finished product. It was undoubtedly the view of all those who held a strict opinion of the acceptance, that it should be confined to the financing of goods in transit—that is, goods which had actually been sold and whose proceeds, therefore, were to be realized as soon as the solvent buyer had been placed in possession of the commodities which had been shipped to him. To permit the issuance of acceptances against tobacco in warehouses or rubber tires in storage was practically equivalent to regarding the acceptance as a note collateralized by warehouse commodities, protected of course by the bank's name, but in other respects no different from a secured note.

Renewal Acceptances

The real issue to be settled in this connection was the position to be taken by the Board with reference to the question of renewals. In substance, the decision arrived at was that, if a transaction has not been liquidated by the time an acceptance given to finance it matures, and if the member bank under the law may in that case renew the acceptance, there was no reason why a federal reserve bank might not discount such a renewed acceptance. It was, of course, provided that a federal reserve bank might not engage in advance to discount any renewals, but this was hardly of much importance inasmuch as no reserve bank engages in advance to discount any particular class or kind of paper, while on the other hand it is the definite understanding that a member presenting eligible paper for dis-

count shall ordinarily be granted the accommodation or advance which he desires.⁷ Probably less important, although of fundamental significance, was the further decision that the reserve bank could not follow the transaction giving rise to an acceptance through to its conclusion in order to see that the proceeds of the acceptance were employed for a productive purpose. It was enough that the acceptance had grown out of an actual purchase and sale, the fact that the acceptance did thus constitute a means of liquidating a transaction being all that was necessary to bring it into conformity with the law.

Summed up, the effect of the discussion of acceptances thus developed by the Federal Reserve Board was that, while national banks or member banks in general could undertake acceptance obligations reaching far into the future, federal reserve banks could not definitely obligate themselves in a corresponding way, and that there was no reason why the acceptances arising under such contracts or obligations, even if they were renewals of paper put out by the acceptor, might not be discounted by federal reserve banks, while the reserve bank itself should not be expected to inquire too narrowly into the uses made of the funds obtained by the issuance of the acceptance. This, in effect, meant that while the reserve system protected itself to the extent of declining to recognize any particular paper as eligible without notice, there was no reason why it might not discount practically anything in the way of an acceptance, provided of course that such acceptance was not merely speculative but had at some time in its history been the outgrowth of an actual purchase and sale of goods.

Growth of Abuses

The breadth of the power to use acceptances thus granted under the rulings of the Federal Reserve Board was more clearly seen as the practice of using acceptances became more general and habitual. It was held by the Board about the

⁷ Ruling of Federal Reserve Board, June 16, 1915, Bulletin, Vol. 1, p. 126

opening of the year 1916, that the liabilities incurred through the acceptance of a draft do not fall within the Section 5200 of the Revised Statutes,⁸ while a series of regulations issued at about the same time greatly loosened the conditions under which acceptances might be made. It was, for example, held that a national bank might accept drafts drawn upon it to finance the importation or exportation of goods under a contract for such importation or exportation, even though unforeseen events later prevented the actual shipment of the goods.⁹ In harmony with this tendency also was the ruling of the Board that acceptances based upon import or export transactions need not be accompanied by evidence actually identifying the specific goods covered thereby.¹⁰ In all of these ways the position was gradually developed that in broadest terms practically any bankers' acceptance that might be drawn in connection with a present, past, or future export or import transaction was eligible for discount at a federal reserve bank, provided that the contract had been entered into in good faith. The obligation to keep the transaction closely connected with a specific shipment of goods had early disappeared, while the renewal plan had rendered it possible to disregard in practice the idea of self-liquidating and short-term credit. The acceptance had thus gradually, step by step, developed into a piece of accommodation paper.

Market Practice

So serious did the conditions in bankers' acceptance practice become in view of these developments, that toward the close of the year 1917 very extensive abuses appeared in the market. The United States was then beginning to feel the financial effects of the war, and money rates were gradually becoming very much higher than they had been. Various large concerns in the effort to finance themselves cheaply were

⁸ Ruling, Jan 3, 1916, Bulletin, Vol 2, p 64

⁹ Ruling, Dec 10, 1915, Bulletin, Vol 2, p 12

¹⁰ Ruling, Nov 9, 1915, Bulletin, Vol 1, p 405

resorting to the use of acceptances upon a basis devised by themselves, with a view to obtaining what was equivalent to a long-term, renewable loan at a rate of interest lower than that prevailing in the market. They could accomplish this result, of course, only by obtaining from some reserve bank an informal preliminary agreement that the acceptances growing out of any given financing should be held eligible for discount, such assurance being regarded as tantamount to a promise or guaranty that they actually would be discounted or bought when presented. Needless to say, it is impossible to show absolutely that any such pledge or guaranty was ever given in writing, but in various cases it was embodied in the advertising literature sent out by the concerns which were financing themselves through the acceptances or by their bankers.

Included in the schemes for obtaining access to cheap funds by means of so-called bankers' acceptances, were plans put forward for protecting such acceptances by means of warehouse receipts, evidencing the existence of stored goods. Probably the best-known case of the kind was found in the acceptances issued by a very large tobacco company. The protection given to the acceptances was simply that of the actual warehoused tobacco, so that as the acceptances were renewable from time to time they constituted in effect a continuing loan or obligation protected by what was equivalent to a mortgage on warehoused tobacco. Inasmuch as a renewal agreement between the syndicate of banks which undertook to market this paper practically insured the regular renewal and sale of the obligations for a specified period of years, it was clear that the tobacco company itself had obtained the use of the funds in question for the length of time covered by the agreement. The acceptances growing out of this agreement, therefore, were liquid only in the sense that they constituted a bankers' agreement to pay at a specified time, but the element of self-liquidation was entirely eliminated by reason of the fact that the

tobacco company was not necessarily under obligation to pay and in any event had secured or protected the bankers chiefly by giving them a mortgage on its manufacturing stock

Acceptance Letter to Banks

The condition of affairs had, as already stated, reached such a pass by the close of 1917, that the Federal Reserve Board in a general letter to reserve banks early in 1918 set to work to correct some of the worst features of existing conditions¹¹ The salient passages contained in this letter were as follows

February 7, 1918

Receipt is acknowledged of your letter of January 29 in which you ask for a statement of the Board's policy in dealing with acceptances drawn under credits extending over a period of one or two years After a very full discussion of the matter, the Board has decided to authorize this expression of its views in accordance with the principles outlined in the memorandum attached hereto The banks of New York may, during a period which can be declared ended at any time, proceed upon the basis of this memorandum in accordance with your letter of January 23 The essential principles may be summed up as follows

(1) Acceptance credits opened for periods in excess of 90 days should only, in exceptional cases, extend over a period of more than one year, and in no case for a time exceeding two years

(2) Banks which are members of groups opening these credits should not buy their own acceptances, and where an agreement is made with the drawer for purchase of acceptances for future delivery, the rate should not be a fixed one, but should be based upon the rate ruling at the time of the sale

(3) Transactions covered by these credits should be of a legitimate commercial nature, and acceptances must be eligible according to the rules and regulations of the Board

(4) Whenever syndicates are formed for the purpose of granting acceptance credits for more than moderate amounts, Federal Reserve Banks should be consulted with regard to the transaction The question of eligibility, both from the standpoint of the character of the bill and of the amount involved, will be passed upon by the Federal

¹¹ Federal Reserve Bulletin March, 1918.

Reserve Bank subject to the approval in each case of the Federal Reserve Board

As stated in the memorandum the Board will rely upon the fair spirit of cooperation on the part of the New York banks, but it must be understood in passing upon these transactions that not only quality but also quantity must be the controlling factors. The aggregate of these acceptances should not be permitted to constitute the greater proportion of outstanding acceptances at any time, and it must be understood that while the Federal Reserve Banks and the Federal Reserve Board might look with favor upon a transaction as long as the total amount involved is not excessive, transactions of exactly the same character may be ruled out whenever the aggregate amount of outstanding acceptances of this character becomes, in the opinion of the Federal Reserve Board, unduly large.

You are authorized to communicate the contents of this letter to the accepting banks of your district, and the Board will advise the other Federal Reserve Banks of the policy which has been agreed upon.

The memorandum referred to, prepared by the Board with a view to outlining its general acceptance policy, read as follows:

In dealing with the question of acceptances, it is desirable that the Board should not be obliged to adopt inflexible regulations unless absolutely necessary. It should be borne in mind that we are competing in the acceptance field with other countries which have no legal restrictions in which sound business judgment, guided from time to time by the central banks of these countries, constitutes the unwritten but none the less rigid law. The banks of the United States would greatly assist the Board in its work of developing a modern and efficient system of American bankers' acceptances—and they would best serve their own purposes—if they would study and assimilate the underlying principles which must guide the Board, and observe these principles voluntarily without requiring inflexible rules. Unless the bankers cooperate with the Board in this manner, many transactions—unobjectionable as long as they are engaged in for legitimate purposes and within reasonable limits—will have to be barred because strict regulations do not admit of discrimination.

Proper regard for conservation of the strength of the Federal Reserve system requires that it must be possessed of short paper well scattered in its maturities (not exceeding 90 days), that when this paper matures it can be actually collected and that the supply of new paper coming into the market can be controlled to a certain

degree by an advance or decline in the rate of interest at which bankers' acceptances are bought. Higher rates will exert a restraining influence on the producer and the dealer and will thereby reduce borrowings and bring about a certain degree of contraction.

By keeping these principles in mind, upon which the strength of our structure depends we can readily understand the hazardous conditions which would be created if, for example, \$300,000,000 of acceptance credits should be opened for the purpose of financing corporations for a period of two or three years, the corporations having secured from the acceptors (directly or by a trading process) a fixed and definite rate of interest for the entire term of the credit. This rate would necessarily be much higher than the current rate for bankers' acceptances. Let us assume that \$300,000,000 had been loaned to corporations at 8 per cent for two years, plus the acceptance commissions. If during these two years the bank rate should advance to 20 per cent, the corporations would not be affected thereby, they would renew from time to time as though money rates had remained unchanged, and consequently, the bank rate, as far as they are concerned, would lose its power to bring about contraction. Thus the acceptance would cease to serve the purpose of financing the borrower, it would be for the purpose of financing the accepting bank. It would really become an accommodation draft for the benefit of the banker, regardless of the current rate and regardless of general conditions, and whether these conditions demand contraction or expansion, the bankers would have to rediscount these acceptances, at a profit or at a loss, if their own position so required. Here, too, the bank rate would lose its power to produce contraction because the commitment is a definite one for two years.

Another flaw in this method of financing is that there is practically no limit to the amount of acceptances which may be created in this manner.

In addition, the rate guaranteed the corporation by the banker would likely be so high as to tempt the accepting bank (having exchanged its acceptance with another bank associated in this business) to rediscount the acceptance with the Federal Reserve Bank or to sell it in the open market. For the accepting bank this transaction would not involve the investment of money as long as the market is able to absorb the acceptances offered. The unavoidable consequence of this process must be in order to prevent an avalanche of these acceptances, the discount rate would have to be advanced so as to reduce the tempting margin and thereby lessen the supply. These

syndicate or accommodation acceptances would therefore tend to raise the rate to the detriment of the legitimate business of the country—particularly the import and export business. When, three years ago, we began our campaign to establish American bankers' acceptances, our rate was $2-2\frac{1}{2}$ per cent and the English rate was about 5 per cent. Our rate has now moved up to $4-4\frac{1}{2}$ per cent while the English rate is about $3\frac{3}{8}$ per cent. This signifies that we have reached a point where American houses find it to their advantage again to draw on English banks, as they did some years ago, rather than upon banks of the United States. It is certain that if syndicate acceptances of this character were offered in European countries the market would at once discriminate against them and put an end to such transactions. It is the application of this rigid principle of keeping the acceptance market primarily reserved for strictly commercial uses that has kept the acceptance business in England in a sound condition and has made the English acceptance market so important an adjunct of the money market.

If in the light of these considerations we seek to apply these principles to actual operations we must reach these conclusions:

There is no reason why a bank should not agree that for legitimate commercial purposes and for transactions complying with the rules and regulations of the Federal Reserve Board, it would commit itself for two years to accept for a customer for importations or exportations, or for the purpose of carrying staples properly warehoused. There is no reason why a bank should not say to a tobacco manufacturer, "Whenever you have tobacco properly stored and for which you will give me proper warehouse receipts, I am willing to accept for you and charge you a commission of — per cent." Whether it would be wise to make a commitment which would force the bank to accept for a customer even when convinced that the borrower is carrying too large a supply of raw material, or that the transaction is speculative, is a question of banking judgment. It would be safer, of course, if the banker could qualify his obligation to accept. But this is an instance where it would be a mistake to lay down a rule and where reliance must be placed upon the business sagacity of the banker, for, in such a case, the borrower would remain subject to the hazards of the money market and any advance in rate would have an effect upon his own commitments.

However, the manufacturer should not feel that, in dealing with a bankers' acceptance he is taking any other risk than that of the interest rate. He should be trained—and this is an important matter—

to understand that he can at any time sell his acceptance, not to the acceptor but to other banks, or through brokers in the market, or to the Federal Reserve Banks. It is much to be desired that the American banks and banking firms should follow the European practice of freely indorsing first-class bankers' acceptances. No drawer of bankers' acceptances in Europe, in normal times, would expect to encounter any difficulty in selling his paper. He can sell it to discount companies or to private banks or bankers, to be rediscounted at rates a fraction above the ruling interest rate (in England for as little as $\frac{1}{8}$ per cent above the discount rate and often less). The manufacturer, after having his bill accepted, should feel quite safe in keeping the acceptance in his portfolio, being confident that, without any further negotiation, he could sell it at any time that he would be in need of cash. Instead of forming syndicates guaranteeing the interest rate to the acceptor banks should make agreements with manufacturing concerns to buy acceptances, from time to time, from the drawees at, say, $\frac{1}{4}$ per cent in excess of whatever might be the ruling interest rate for bankers' acceptances. In this way a real discount market would be developed in this country. Federal Reserve Banks will, sooner or later, have to adopt the European rule of buying only paper bearing a third name, viz, the indorsement of a bank, banker, or responsible firm.

It is true that the banks accepting in the present syndicate transactions make an additional profit in the interest rate which they guarantee to the borrower. It is suggested, however, for their consideration that it would be a sounder policy if they would charge a higher acceptance commission for domestic transactions of this kind, for larger commissions would be justified for credits extending over a considerable period. This would be sounder than to adopt a policy which, if permitted freely to develop, would undermine the safety of our acceptance system and our money market.

The principles governing the acceptance are equally applicable to single-name paper. A bank may agree to carry a customer over a period of a year and to buy from time to time his single-name paper. If this paper, according to the statements submitted, should be eligible in other respects, Federal Reserve Banks might discount it, provided the paper is not part of a loan which has been negotiated at a fixed rate for a definite period, a year or two, for example. A 90-day note made under a definite renewal agreement in this way is a camouflage for the convenience of the banker to enable him to finance himself by using the 90-day form as a mask to conceal what is, in

effect, an ineligible 1-year note. But if the interest rate should remain open between borrower and lender subject to adjustment to the market rate, a different aspect would be presented, and the Federal Reserve Banks might discount such notes within reasonable limits.

When a credit is required for two years it should be regarded as an unsound basis for commercial borrowings on 90-day paper. Without a guaranty for renewals it would be dangerous for the borrower. With such a guaranty it would be an unsound banking credit. A demand for one or two year money, except for special contracts, indicates a need for greater working capital which ought to be obtained by increase of capital or sale of obligations in the investment market.

It may be argued that there is at present no investment market, and therefore these renewal transactions are necessary. But does the abrogation of the investment market afford a reason for the destruction of the commercial paper market also? Some plan must, and will be developed to restore to a certain extent, at least, the security market. But even if this restoration can not be effected, should we not look upon credit as a commodity of which only a limited supply is available? If we have approached the limit, would it not be wise to conserve credit and apply it only in those directions where its use will most greatly benefit the country? In the case of the Tobacco Co., if it had not secured the full credit it sought it would in that event have bought less tobacco and possibly might have advanced its selling prices. What if it had reduced its inventories and the consumption of tobacco? Would not this have been just what is at present required? The corollary is that business must adjust itself to credit, not credit to business at this time.

To recapitulate. Agreements to grant credits for an extended period by the purchase of 90-day paper or by 90-day acceptances ought to be based upon transactions connected directly with the purchase and sale of goods and the intermediate process of manufacturing. Credits so extended should relate to the resources of the borrowing concern and should not be granted for the purpose of furnishing working capital or for the temporary financing of permanent investments.

These transactions should be of an individual character, they call for direct contact between banker and borrower, and syndicate credits should be avoided. Agreements by bankers to furnish one or two year money at a definite rate of interest against 90-day paper or acceptances to be used to finance themselves should not be counted

nanced either openly or in the form of exchange of paper between bankers

These are the principles which the Federal reserve system must apply. It would be inexpedient to attempt more than to establish the principles. It would be detrimental to formulate definite regulations dealing in minute detail with the various phases of the problem. It would be far better to give some latitude to the banks in dealing with these matters. But this will depend entirely upon the wisdom and discretion of the member banks. The banks will best serve their own interests if, following the example of European institutions, they will adopt these principles as self-imposed, well-tried rules of business prudence rather than by abusing their freedom of action to force the Board to tie their hands by rigid regulations.

It is doubtful whether this letter of the Board's produced any material improvement. Bankers, while taking advantage of the permission which it conveyed to make long-term acceptance renewal agreements, simply disregarded the safeguards which had been outlined in the letter, on the ground that there was no basis in law to compel observance of them. They were, in other words, perfectly willing to accept relaxations of control obtained from the Federal Reserve Board, but they were not willing to abide by the offsetting or compensating restrictions imposed by the same authority. The suggestion contained in the letter which referred, for example, to the fact that acceptances should not be discounted by the bank which made them, has been habitually disregarded on the ground that it represented an ideal or impossible condition of affairs.

Shortcomings of Acceptances

Analysis of current acceptance contracts showed that, notwithstanding the adoption of various safeguards suggested by the Board or devised by the banks for their own protection, operators had practically discarded or sacrificed every element of safety or protection that was supposed originally to inhere in the acceptance idea. The criticisms to be based upon those acceptances may be enumerated as follows:

1 They did not identify specific transactions with specific acceptances

2 They did not provide for the liquidation of acceptances at any given time, this being avoided by the renewal contract plan

3 They did not in the case of export and import operations necessarily involve any exportation or importation whatever, since the acceptance might be had in advance of shipment and merely in the belief that it was to take place

4 They did not provide for differentiation between accepting and discounting, but on the contrary the syndicate agreements between groups of banks were distinctly based upon the idea that the acceptances would be passed about or allotted in specified proportions from time to time, so that the idea of a "market" entirely disappeared and the borrower was practically assured of loans running over a long period at a stable rate of interest which might or might not correspond to the market rate

5 They did not necessarily even involve a commercial transaction, since they might be drawn merely for the carrying of warehouse goods

6 They did not afford the alleged opportunity of investment, inasmuch as under the renewal contract system the placing of the acceptances was provided for in an artificial and definitely arranged way

7 They did not necessarily represent goods that were in existence at all, since the original goods which had given rise to the drawing of the acceptance might have been used up in unproductive ways or might even have been destroyed. At the end of the war, the bankers' acceptance was probably in even worse condition than the trade acceptance. Its advantage from the standpoint of the investor, whether bank or individual, was that such acceptances represented the direct obligation of banks whose strength could be tolerably well ascertained, and that they were therefore under any normal

conditions practically assured of settlement at maturity out of any funds that the bank may have on hand

8 They did not take their chance in the market at ordinary running commercial rates, notwithstanding that their character entitled them to no preference over other paper, but they received a preferential rate whose only basis had to be found in the fact that they were the paper of a bank rather than of an individual or corporation, and was in no sense due to superior liquidity based upon investigation made by a special bank into the transaction underlying the operation

Later History

Like the trade acceptance, the bankers' acceptance suffered a loss of standing and significance during the war, and failed to recover after the close of the struggle. As time went on, it came to be used more and more for long-term and refinancing projects. There was constant trouble with the acceptance and eventually the Board was induced in 1922 to transfer the whole question of oversight of acceptance practice to reserve banks locally. It thus withdrew from this field of credit supervision and control, just as it had in the case of single-name paper and of trade acceptances. The abuses which had already appeared continued to develop, and in 1922 became so serious as to call forth a scathing report from a committee of national bank examiners who filed it with the Comptroller.

APPENDIX A TO CHAPTER XLIV

House Bill 15038 "proposing an amendment to the Federal Reserve Act relative to acceptances, and for other purposes" grew out of the fact that as the act stood, there was a limitation upon the amount that any national bank could make of acceptances based upon the exportation or importation of goods. The amount of acceptances, to be issued was not to exceed one-half of the paid-up capital stock and surplus of the bank for which the rediscounts were made and no amount in excess thereof could be rediscounted. The law provided, furthermore, that reserve banks could rediscount acceptances with

a maturity of three months only In the meantime it had been urged by the Organization Committee of the federal reserve system that there existed a number of banking institutions that made a specialty of financing the exportation of grain, cotton, etc These banks had built up a business, greater than could be accommodated on the acceptance plan, by reason of the limitation in the bill Mr Glass introduced on the 25th of March, 1914, a bill proposing to invest the Federal Reserve Board with the power to suspend this limitation from time to time and permitting six months' acceptances to be rediscounted Consideration of the bill was not urged until August 15, when Mr Glass brought it forward upon his own initiative, not having been able to get together a quorum of the Committee on Banking and Currency

" Now, with this European war confronting us, it is desired by the Federal Reserve Board to facilitate in every possible way the exportation of our grain, cotton and other products and this is a simple proposition to authorize the Federal Reserve Board to suspend the limitation upon the amount of acceptances that an individual bank may discount or that the regional bank may rediscount " (Congressional Record, Vol 51, p 13819) When the question was raised, why the limitation had been put into the act originally, Mr Glass referred to the controversy in the Democratic caucus over the maturity of agricultural paper The point had been made by some members of the caucus that a six months' privilege would be extended to the banker and not to the farmer "We did not seem able to explain to the satisfaction of that member that conditions were different, and that these six months were necessary to consummate export transactions with the Orient and with the South American Republics, but not necessary to close up domestic transactions" (p 13820) Objection was raised against further consideration by a member of the Committee who insisted upon considering the measure in the Committee The bill was reported back on December 8, with some minor amendments in wording It passed the House without further discussion Without any mention by Mr Glass or any other member, a change had occurred in the draft of the bill Whereas in the draft, as read on August 15, it had been provided that federal reserve banks may rediscount acceptances of six months' maturity (Vol 51, p 13819), the maturity was reduced to three months in the draft of December 8 (Vol 52, p 33)

Mr Owen's attempt to get a unanimous consent-agreement for consideration of the bill in the Senate failed both in January and February, and not until the 1st of March, 1915, was the measure

taken up Upon Mr Bristow's objection that too much power was given to the Federal Reserve Board if it should have the unlimited authority to permit banks to control the acceptance business, an amendment was added by Mr Owen modifying the original limitation of one-half of capital and surplus so as to permit issue of an amount equal to the entire capital and surplus to be issued The amendment as amended was agreed to

The House concurred in the Senate amendment on the 2nd, and the bill was signed on the 3rd of March, 1915

APPENDIX B TO CHAPTER XLIV

The following report on English banking practice was obtained by some members of the Board from a confidential source as a guide in forming the acceptance regulation

REPORT ON BRITISH BANKING PRACTICE

Referring to our conferences prior to my recent trip abroad I beg to report herewith upon the results of my investigations and conferences while in London with respect to the various items on which you desired information as to English banking practices and experience

It was my good fortune to secure the data and views on which this report is based through personal discussions with high financial authorities, not merely those of one classification, but from gentlemen engaged in the several diversified functions which together compose what I might term England's comprehensive banking system

Considered on general lines, there is some basis for comparison between the British banking system and our own The joint stock banks and other banking institutions have a relation to the central bank (the Bank of England) somewhat analogous to the relation that our member and non-member banks bear to the central control in this country as represented by the Federal Reserve Board Marked differences which do actually exist between the two make many of their customs impracticable for use by our Federal Reserve System Nevertheless the older system through a longer experience suggests the adoption of certain other features which might be adapted with results beneficial to the American plan

The tendency in this country to restrict and supervise corporations of all kinds has been exemplified in no more marked degree than in the case of our banking institutions, nor do I mean to indicate that with the very different conditions which have surrounded and do

surround the development and present administration of our banks careful regulations are not necessary. There is no better illustration of this point than that part of our Federal Reserve Law which limits a national bank in the amount up to which it may accept, and without further general comment I will proceed to take up in order the various points with which your letter chiefly dealt.

As you correctly understand, there is in England no limitation whatever created by law as to the total amounts which either public or private banking concerns may accept. However, in an undefinable way there exists an unwritten law which has operated in such a manner as to almost without exception provide against undue extension in this direction.

✓ Until quite recently the English joint stock banks have accepted a comparatively small amount of bills on their own account, having preferred to purchase such acceptances as they desire for their portfolios from the bill brokers or "discount houses," whose position, as the purchasers of acceptances from the accepting houses, and as sellers of these bills to the joint stock banks, has been built up from a custom existing for generations past. The recent noticeable increases in acceptances by joint stock banks have been chiefly due to curtailment by the acceptance houses of their own outstanding volume.

As a concrete illustration of the foregoing I might quote from the annual statements of one of the largest banks, which for a few years prior to 1915 shows an average acceptance liability of about \$30,000,000 compared with an average holding of bills of exchange as investments of about \$60,000,000, the proportion of bills accepted on their own account to outside acceptances purchased thus being in the ratio of 1 to 2.

Furthermore, it is worthy of note that when bills of either class except foreign bills, once find their way to a clearing bank such as the one quoted here, they remain there until maturity, which is a sound tradition that has come down from the old private bankers of London. While in the case of France and Germany pressure can be relieved by rediscount with the Government Banks, the Clearing Banks could hardly do this with the Bank of England without using up the reserve they keep there, thereby vitiating the reserves as such.

It is also noteworthy that the joint stock banks of England regarded this form of short-term investment so highly, even when rates of discount are slightly under normal levels, that they are inclined to put their funds into bills of exchange in preference to such securities as British Consols, which for several years prior to this showed

a lesser income return than the former. The natural consequence of this market competition between acceptances and government bonds has been depreciation in the value of the latter, augmented by heavy sales on the part of banks and other companies in order to avoid these depreciations, this has been likewise very true in France in the case of Rentes.

These joint stock banks, whose statements are published semi-annually (in some rare instances, monthly), show as a liability in their balance sheets the amount of acceptances which they have assumed, offset of course by a corresponding "per contra" credit entry. To gauge the volume of this kind of business merely from these items would be wholly misleading in determining the volume of acceptance business which is done in England, since many times as much as is publicly shown in the statements of the joint stock banks is done by the acceptance houses which, being firms of a private character, publish no statement from which the general public can even approximate the total amount of acceptances which they have undertaken. Among such firms I might name a few which are typical:

Rothschilds,
Brown, Shipley & Co.,
Morgan, Grenfell & Co.,
J. C. Hambro & Sons,
Kleinworts, Sons & Co.,
Schroeder,
Brandts, Son & Co.

Firms of this kind feel no necessity for making public their balance sheets, being restricted by no legal requirements whatever in the amount up to which they may accept, but it would be erroneous to suppose that there is no effective means of restraining these firms from the danger of over-extension. To express this point succinctly, one might say that their accepting limit is governed by their credit with the banks and the extent to which the banks will purchase their paper.

Assuming that the fundamental factor in turn governing their credit is the relation of their assets to liabilities, or, to be more specific, the proportion of their capital to outstanding acceptances, and with the knowledge that such firms make no public statements of their standing, the question arises by what means can the banks ascertain whether this or that firm is exceeding a limit which would be considered wise. But the banks, who as I have stated are the purchasers of the acceptances of these firms through the bill brokers, do learn this in a truly remarkable manner, and if not to the precise

amount, they know at least to a very close approximation. A number of things contribute to the acquisition of this information. First, they may to a large extent gauge this by the frequency or volume in which the acceptances of any one firm appear in the mixed batches of bills which are daily offered them by the discount houses. Again they have a good idea of the capital and general credit of these private firms. Needless to say the bank or banks with which the private firm deals know accurately the condition of that firm, for English banks to an extent far greater than our own require of their customers intimate knowledge of their condition. Therefore, since each one of these private firms banks with some joint stock bank, it would be manifestly easy for the joint stock banks by concerted action to learn with considerable accuracy whether and to what extent a firm might be accepting in an imprudent amount. I do not mean to say that there is any formal association or comparison of notes on this subject by the banks, their long experience provides them with a subtle but nevertheless infallible means of checking this question, and then the operation of restricting the house which may be over-extending is a comparatively simple one, based upon the natural law of supply and demand. A joint stock bank receiving in its daily offerings too many acceptances of one house, or with too great a frequency, will from the lot of bills pick out this item, and say to the bill broker, that they do not care for it, that they have a sufficient line of that particular name. This reacts through the bill broker very directly on the accepting house, whose bills, if the extension is continued, will depreciate, but it is generally the case, before this point is reached, that retrenchment takes place without further pressure being exerted.

Amongst the greater accepting houses of London, there are three, whose names I will not mention here, but concerning whom I have obtained an approximate idea of the ratio of their capital to outstanding acceptance. This should be considered merely an estimate, although I have good reason for believing that it is fairly accurate. For convenience we will call the houses in question Jones Brothers, Brown & Company and Smith & Sons

Jones Brothers, capital five and a half to six millions sterling, with acceptances outstanding of £18,000,000
 Brown & Company, capital four to five millions sterling, with acceptances outstanding rather under £18,000,000
 Smith & Sons, capital two and a half millions sterling, with acceptances outstanding of about £18,000,000 or slightly less

I have stated above that these houses show their balance sheets

privately to their bankers, and I am reliably informed that they do in fact show their balance sheets also to the Bank of England. Therefore in the various ways I have indicated the discount market is enabled to constantly possess a very fair idea of their position.

In the foregoing I trust I have answered those questions contained in the first part of your letter. It is shown that in England there is no legal limit to the amount of acceptances which may be assumed by either banks or private firms, but I have also endeavored to show the factors which contribute towards the establishment of what might be termed a voluntary limit. Other than as hereinbefore indicated there cannot be said to be a "commonly accepted limitation."

With respect to the relative responsibility of the respective parties to a completed acceptance,—maker, acceptor, endorser,—and your question as to whether the endorsement of an acceptance by a responsible party in practice releases the acceptor from a part of his liability I find a unanimous opinion to the effect that it does not.

While the holder of a bill presents it for payment of course at the office of the acceptor, the liability of the endorser is considered a great safeguard. The English banker takes the position that if a bill is refused payment in full by the acceptor, by whom it is payable on the date when that bill becomes due, he has in addition equal recourse to the endorser or endorsers. He reasons that the acceptor may at least be able to pay a composition amounting to, say, ten shillings in the pound. In turn he may collect from the endorser appearing on the back of the bill (from whom he bought it) a composition amounting to perhaps five shillings in the pound. For the balance he still has the right of recourse upon the other endorsers, if any, until ultimately if he has not collected the full amount due him he reaches the drawer of the bill. He figures that between them all he is almost certain to secure his full twenty shillings in the pound for the total amount of the bill.

With respect to your inquiry whether

"as a matter of practice, are the makers of paper, the acceptors and the endorsers graded so as to enable the bank buying an acceptance to gauge the character of the security,"

I find that there is no grading of the makers, acceptors and endorsers of a bank bill which can be expressed in difference of rate. While there is of course a difference in standing of different firms or institutions, parties to the acceptance, it finds no expression except in their marketability, as in England the actual market rate for prime bills is uniform. In other words it is noticeable not only in the degree of

single responsible name. He pointed out that in the past year the London market had been financing most of the purchases of the allies from America, that is to say that neither Russia nor France, especially the former, is solely responsible to the United States for their purchases here, but that the financing is done via England and that the Russian bill in particular is virtually backed in London.

APPENDIX C TO CHAPTER XLIV

Following is Regulation R, Series of 1915, superseding Regulation J of 1915, issued by the Federal Reserve Board, September 7, 1915

FEDERAL RESERVE BOARD BANKERS' ACCEPTANCE REGULATIONS

BANKERS' ACCEPTANCES

I Definition

In this regulation the term "acceptance" is defined as a draft or bill of exchange drawn to order, having a definite maturity, and payable in dollars, in the United States, the obligation to pay which has been accepted by an acknowledgment written or stamped and signed across the face of the instrument by the party on whom it is drawn, such agreement to be to the effect that the acceptor will pay at maturity according to the tenor of such draft or bill without qualifying conditions.

II Statutory Requirements under Sections 13 and 14

Section 13 of the Federal reserve act as amended provides that—

(a) Any Federal reserve bank may discount acceptances—

(1) Which are based on the importation or exportation of goods,

(2) Which have a maturity at time of discount of not more than three months, and

(3) Which are indorsed by at least one member bank

(b) The amount of acceptance so discounted shall at no time exceed one-half the paid-up capital stock and surplus of the bank for which the rediscounts are made, except by authority of the Federal Reserve Board and of such general regulations as said Board may prescribe but not to exceed the capital stock and surplus of such bank

(c) The aggregate of notes and bills bearing the signature or indorsement of any one person, company, firm, or corporation rediscounted for any one bank shall at no time exceed 10 per cent of the unimpaired capital and surplus of said bank, but this restriction shall

not apply to the discount of bills of exchange drawn in good faith against actually existing values

Section 14 of the Federal reserve act permits Federal reserve banks, under regulations to be prescribed by the Federal Reserve Board, to purchase and sell in the open market bankers' acceptances, with or without the indorsement of a member bank

III Ruling

The Federal Reserve Board, exercising its power of regulation with reference to paragraph II (b) hereof, rules as follows

Any Federal reserve bank shall be permitted to discount for any member bank "bankers' acceptances" as hereinafter defined up to an amount not to exceed the capital stock and surplus of the bank for which the rediscounts are made

IV Eligibility

The Federal Reserve Board has determined that, until further order, to be eligible for discount under section 13, by Federal reserve banks, at the rates to be established for bankers' acceptances

(a) Acceptances must comply with the provisions of paragraph II (a), (b), (c) hereof

(b) Acceptances must have been made by a member bank, non-member bank, trust company, or by some firm, person, company, or corporation engaged in the business of accepting or discounting. Such acceptances will hereafter be referred to as "bankers'" acceptances *

(c) A banker's acceptance must be drawn by a purchaser or seller or other person, firm, company, or corporation directly connected with the importation or exportation of the goods involved in the transaction in which the acceptance originated, or by a "banker". The bill must not be renewed after the goods have been surrendered to the purchaser or consignee, except for such reasonable period as may have been agreed upon at the time of the opening of the credit as a condition incidental to the importation or exportation involved, provided that the bill must not contain or be subject to any condition whereby the holder thereof is obligated to renew the same at maturity

(d) A banker's acceptance must bear on its face or be accompanied by evidence in form satisfactory to a Federal reserve bank that it originated in, or is based upon, a transaction or transactions in-

* Drafts and bills of exchange eligible for rediscount under section 13, other than "bankers'" acceptances, have been dealt with by Regulation B, series of 1915

volved the importation or exportation of goods. Such evidence may consist of a certificate on or accompanying the acceptance to the following effect:

This acceptance is based upon a transaction involving the importation or exportation of goods. Reference No. _____ Name of acceptor _____

(e) Bankers' acceptances, other than those of member banks, shall be eligible only after the acceptors shall have agreed in writing to furnish to the Federal reserve banks of their respective districts, upon request, information concerning the nature of the transactions against which acceptances (certified or bearing evidence under IV (d) hereof) have been made.

(f) A bill of exchange accepted by a "banker" may be considered as drawn in good faith against "actually existing values," under II (c) hereof, when the acceptor is secured by a lien on or by transfer of title to the goods to be transported or by other adequate security.

(g) Except in so far as they may be drawn in good faith against actually existing values, as under (f), the bills of any one drawer drawn on and accepted by any firm, person, company, or corporation (other than a bank or trust company) engaged in the business of discounting and accepting, and discounted by a Federal reserve bank, shall at no time exceed in the aggregate a sum equal to a definite percentage of the paid-in capital of such Federal reserve bank, such percentage to be fixed from time to time by the Federal Reserve Board.

(h) The aggregate of acceptances of any firm, person, company, or corporation (other than a bank or trust company) engaged in the business of discounting or accepting, discounted or purchased by a Federal reserve bank, shall at no time exceed a sum equal to a definite percentage of the paid-in capital of such Federal reserve bank, such percentage to be fixed from time to time by the Federal Reserve Board.

To be eligible for purchase by Federal reserve banks under section 14, bankers' acceptances must comply with all requirements and be subject to all limitations hereinbefore stated, except that they need not be indorsed by a member bank. *Provided, however,* That no Federal reserve bank shall purchase the acceptance of a "banker" other than a member bank which does not bear the indorsement of a member bank, unless a Federal reserve bank has first secured a satisfactory statement of the financial condition of the acceptor in form to be approved by the Federal Reserve Board.

V Policy as to Purchases

While it would appear impracticable to fix a maximum sum or percentage up to which Federal reserve banks may invest in bankers' acceptances, both under section 13 and section 14, it will be necessary to watch carefully the aggregate amount to be held from time to time. In framing their policy with respect to transactions in acceptances, Federal reserve banks will have to consider not only the local demands to be expected from their own members, but also requirements to be met in other districts. The plan to be followed must in each case adapt itself to the constantly varying needs of the country.

APPENDIX D TO CHAPTER XLIV

The following "History of the Development of the Acceptance Regulations" was prepared late in 1915 by a member of the Board. It was generally circulated and produced various replies. In reprinting it personal references are omitted wherever possible because replies thereto could not be given at length for lack of space.

HISTORY OF THE DEVELOPMENT OF THE ACCEPTANCE REGULATIONS

In developing the acceptance regulations of the Federal Reserve Board during the year 1915, the main point of discussion has been the question of how large a scope should be permitted to this branch of banking. It is safe to say that the majority of the Board, when the deliberations began, took the view that the acceptance business would be a kind of specialty in which the banks in the large centers were chiefly interested while the primary function of the system was to take direct care of the requirements of the country as expressed in promissory notes, and, what we have now designated as trade acceptances. Even the clearing function was by some apparently thought to be of more importance than the development of the acceptance business.

From the beginning, I held, and tried to impress upon my colleagues, the view that acceptance business was not a luxury; that it was not a subtraction from other sections of the country, but was rather an added benefit to all, that it was destined to become a most important factor in our system, not of subordinate but of equal importance to the single name and trade acceptance business, and, in the future, sure to become more important for the development of the system than any other class of paper.

As against this view, there was a constant effort by a majority of the Board to restrict the development of the acceptance business to what they considered safe lines, which were rather the minimum than the maximum which could be given it. Many months were consumed in these discussions, invaluable indeed not because the Federal Reserve Banks lost an early opportunity of earning money from this source, but because the member banks did not get that early start in launching themselves at full speed into this business which it was of the greatest importance for them and for the country to make.

Gradually, the weight of opinion turned in favor of the more liberal action. Even after the Board's first regulation had been adopted and after actual operation had amply shown that, if the Federal Reserve Banks were restricted to purchasing only member bank acceptances or non-member acceptances when indorsed by member banks, they would secure only a very limited amount of business, he suggested to the Board that we reverse the policy then adopted and abandon the purchase of unindorsed acceptances of non-member banks.

While, however, the questions of "member bank" or "non-member bank" and of "Section 13 or Section 14" consumed the main attention during these months, there were several incidental questions which developed from time to time and in which the same spirit and alignment were shown.

One of these questions was the construction of the meaning of the term "importation or exportation." As early as January 3, 1915, the records show that I tried to construe importation and exportation as including shipments not only between the United States and foreign countries, but also between foreign countries.

Early in May, in view of the approaching Pan American Financial Conference, . . . Secretary McAdoo asked my views on the question how we could best financially serve the Pan American Republics. I told him that there were very few things that the Federal Reserve Banks could really do, with the possible exception of two on the one hand, by acceptances, our member banks could finance their business—export or import—not only with us, but with other countries, just as England has heretofore done, while on the other, we could assist the development of trade by forward discount quotations. I told him also that, for months past I had urged my colleagues to proceed on these lines. He said without hesitation that he agreed with my views and would vote accordingly.

CLAUSE (e)

A clause of lesser importance, but worth mentioning 15
clause (e)

The draft (January 3, 1915) contained a paragraph reading as follows

"(e) When goods sold or consigned, or a lien thereon, form the security for an acceptance, it may be considered as drawn in good faith against actually existing values as under I (c) *supra*"

In the draft of January 14, this clause was amended to read as follows

"(e) When goods sold or consigned, or a lien thereon, form the security for an acceptance, it may be considered as drawn in good faith against actually existing values, as under I (c) hereof, when it is adequately secured by the goods to be transported, or a lien thereon, *or, in case of release of such lien, by other adequate security to be substituted therefor*"

After the regulation had been in operation for some months, it was found necessary to provide for this substitution and ultimately the language was reinserted in our second amended regulation of April 2

With the same purpose of avoiding any possible abuse, Mr _____ suggested that there be inserted a clause to the effect that the amount of acceptances should not be in excess of the approximate value of the goods to be imported or exported. This clause was later omitted because it was felt that, in case of shrinkage of value, the clause might prove embarrassing, and because it was felt that we should not insert in the regulation provisions which would make supervision unnecessarily burdensome. The clause was put in and then eliminated. And again, . . . was inserted, but later it was eliminated once for all

CLAUSE (c)

On January 15, the Board was apprised of a credit operation to be undertaken for the Russian Government. It involved the issue of drafts on American bankers by the Russian Ambassador. The question arose whether these drafts should be admitted to rediscount at Federal Reserve Banks. The question was fully discussed, both from the economic and from the political point of view. The problem involved the broad question of finance drafts, and the Board finally took the position that it was not desirable for the Federal Reserve System to take any finance drafts, and that, by adopting this policy, the political question whether or not acceptances drawn by belligerent

powers could properly be taken by the Federal Reserve Banks was eliminated. To this policy there was no dissenting voice.

On January 15, the Board adopted a clause reading as follows:

"(bb) Such acceptance must be drawn by commercial or agricultural concerns (person, company, firm or corporation) and connected with the importation or exportation of goods involved in the transaction against which the acceptance is drawn."

Originally the clause read

"(c) Such bankers' acceptances must be bills drawn by *or for account of* a commercial, etc."

This "or for account of" would have had the effect of enabling banks to draw for account of commercial firms. The Board, however, at that time, did not wish banks to draw. It was felt that commercial firms should draw themselves. The clause was then changed into "drawn by *and for* account of a commercial, etc." This again would have been very stringent because, in that case, a commercial firm could not have drawn for account of a government.

The Board finally decided to insert in the clause (bb) the words "and for account of" which had been stricken out, so that ultimately the paragraph read "drawn by a commercial firm, etc., directly connected with the transaction." This permitted a commercial firm to draw on an American bank for account of a foreign government.

The draft of January 28 was accompanied by a memorandum . . . in which special attention [was given] to the fact that the phraseology excludes both banks and governments as drawers.

It must be remembered that, at that time, the Administration had publicly taken the attitude that it did not look with favor upon American loans to belligerent powers. The minutes of the Board contain the following record, which, though unusual, it was thought necessary to make just in view of the important bearing that this question might have:

"Mr. Hamlin reported that he had submitted the text of the circular and regulation relating to acceptances to the Secretary of the Treasury, who had been unable to attend the meeting at which they were finally adopted, and that the Secretary had no further suggestions to make."

Governor Hamlin's memorandum, submitted to Mr. McAdoo, read as follows:

"EXTRACT FROM ACCEPTANCE REGULATIONS"

"A bill drawn for account of *and* by a commercial, industrial, or agricultural concern (that is, some company, firm, corporation,

or individual) *directly* connected with the importation or exportation of the goods involved in the transaction out of which the acceptance has originated"

This permits the seller or buyer, at home or abroad, to draw the bill

It excludes

- (a) Bills which are in effect loans unconnected (or only indirectly connected) with the specific sale of merchandise, i.e., finance bills
- (b) Drawings of bills by or for account of any foreign government, such bills or acceptances being in effect loans to such governments

II

Federal Reserve Banks have no right under the Act to discount acceptances which in effect are merely a device for loans to foreign governments

Federal reserve banks are in essence government institutions

- 1 The government appoints 3 out of the 9 directors
- 2 The government can remove any or all of the directors for cause
- 3 The government takes to itself all profits—by a franchise tax—over and above the expenses, 6% dividend and the fixed surplus fund
- 4 The government, through the Federal Reserve Board, has the power to control the actions of the Federal reserve banks, and it is the duty of the Federal Reserve Board to insist that the law shall be obeyed as laid down in the Federal Reserve Act
- 5 The government has ruled that the capital and resources of these banks are not subject to the International Revenue tax This ruling based upon the fact that the Federal reserve banks are not in essence banks but are in fact government institutions controlling the member banks in the interests of the public
- 6 Federal Reserve banks, under the Federal Reserve Act, cannot loan directly to foreign governments, nor buy the bonds, notes, or warrants of foreign governments
- 7 Being in effect government institutions and carrying government deposits and being fiscal agents of the government, a loan, directly or indirectly, by such institutions to a foreign government is in effect the same as if the United States Government itself made a loan to such foreign governments
- 8 It is well settled in international law that a neutral government may not furnish assistance in the way of loans of money or supplies of war to a belligerent
- 9 Not only must a neutral State refrain from such loans, but it also is bound to use its power to *prevent* any such breach of neutrality
- 10 The United States is, therefore, bound to take the necessary steps to prevent the Federal reserve banks, essentially government institutions, from making, directly or indirectly, such loans to foreign governments in breach of the obligations of neutrality
- 11 Even apart from any question of neutrality, the Federal Reserve

Board should insist that no device be permitted to bring about a violation of the Federal Reserve Act by a loan, directly or indirectly, to a foreign government

III

The acceptances in question, if discounted by a Federal reserve bank would violate the Federal Reserve Act because their discount would amount in law to a loan or to the purchase of the obligations of a foreign government, which is not permitted under the Act

e.g. The bills in question are said to be drawn by the Russian Ambassador upon banks or bankers which represent in this transaction the Russian government. They are in effect promissory notes of said government

IV

The acceptances, it is said, are to be renewed at maturity, thus showing that their real intent is a loan to said government

Such acceptances could not lawfully be discounted as they really mature more than 3 months later than the time of discount

V

The government, as a neutral power, is bound to take the necessary steps to prevent its own instrumentalities being used to give assistance in the way of loans of money to a belligerent

VI

There is no element of liquidity in such transactions, for there is no commercial transaction subsequent to the first sale which will provide the funds to be furnished to the acceptor so that he may meet the acceptance. For example, if such acceptances were universally given and discounted by banks and bankers over the whole commercial world, there would be no certainty that they would be paid by the acceptors at maturity. It would depend entirely upon the ability of the foreign government to furnish to the acceptor funds with which to meet the acceptances and such ability is notoriously a very uncertain quantity, depending as it does upon the power of taxation rather than upon the possession of funds derived from a commercial transaction.

An instance of this uncertainty is afforded by the failure of the firm of Baring Brothers, in England. In 1890 the Argentine Government had drawn bills upon Baring Brothers to provide funds for various public improvements. When the bills matured the Argentine

Government could not furnish the funds to meet them, and the result was the failure of Baring Brothers, which may be said to have precipitated a financial crisis which extended all over the civilized world

Another memorandum read as follows

Washington, February 6, 1915

In writing its acceptance regulation, the Board had of necessity to bear in mind the problem of what attitude Federal Reserve Banks should take in case they should be offered acceptances drawn for the purpose of financing transactions involving the importation or exportation of goods but drawn for account of foreign governments

The question had to be considered from several points of view—one the broad economic basis, involving the question of whether foreign governments shall be permitted to finance their requirements by using the rediscount facilities of the Federal Reserve Bank System or whether they should not be forced to do their financing in the security market by selling their long term bonds or short term treasury notes. In the latter case, the appeal is to the investor, while if permitted to rediscount their bills of exchange drawn on American banks they would absorb the funds of the bill market, that is to say, the facilities which properly should be reserved for the requirements of commerce and trade, and for the individual borrower. One might say, for the "smaller" borrower, because what applies to a government would apply with equal force to the large corporations, for their requirements go into hundreds of millions and, for this same reason, they should not be permitted to absorb the commercial credit facilities of the banks of the country. They have at their disposal the broad security market, which is not available for the individual borrower. The scope of the operations of such large corporations and governments is such that, if permitted to borrow on a large scale by using short term banking credits, they would be apt to absorb the bulk of the credit facilities of note issuing institutions, and the consequence would be that whatever would be left for the individual borrower would be available for him only at so much higher price.

If, to illustrate, a government wanted to sell six months treasury notes on its own credit, it might be able to do so only upon an eight to ten per cent basis if it appealed to the investor direct. If a banker steps in between and, for a sufficient compensation, is willing to take the risk and substitute his own credit by giving his acceptance, the investor puts up his money at, let us say, three per cent. The difference has gone to the government and to the guaranteeing banker. As a matter of fact, the transaction results in the foreign government selling its six months warrant with the guaranty of the American banker and selling it in the bill market instead of the security market at three per cent instead of eight per cent.

To further illustrate, if the reserve banks would buy \$25,000,000 of these acceptances at three per cent, it is probable that they would have to put up the rate at once for their further purchases of acceptances as they may be offered by others for the financing of importations and exportations, for their means available for this purpose would have been largely absorbed, and it is easy to see that the transactions might well take a larger scope and seriously

interfere with the program outlined for the Federal Reserve Banks. Furthermore, it should be considered that the law struck out the power of Federal Reserve Banks to invest in foreign warrants. The Federal Reserve Banks are permitted only to buy warrants issued by states and municipalities of the United States. The financing of foreign governments was advisably eliminated from the Act.

Foreign government banks have adopted very definite methods to rule out from their transactions what they call "finance bills", that is to say, bills that are not based strictly on commercial transactions but such that are drawn for account of banks or brokers for the purpose of carrying bonds or stocks or so-called "financing." There is no doubt that the Federal Reserve Banks will have to adopt a similar policy of self-protection in this respect. The Federal Reserve Board for this reason included in its regulation a clause II(c) providing that a banker's acceptance must be "a bill drawn for account of and by a commercial, industrial or agricultural concern (that is, some company, firm, corporation or individual) directly connected with the importation or exportation of the goods involved in the transaction out of which the acceptance has originated." This would bar such transactions as would be drawn for account of a foreign government or a finance institution.

If this broad view be adopted, it would dispose of the second angle from which the problem will have to be viewed, that is, the question of whether Federal Reserve Banks should purchase bills drawn by or for account of foreign governments which are belligerents. One particular case is actual, it is the question of Russian bills drawn, as the Board has been informed, by the Russian Ambassador, on certain banking firms for the purpose of financing goods to be exported. The question involved in this case offers a very simple proposition. These bills show on their face that they are drawn for account of a foreign government at war, and the question is, shall these bills be purchased by a bank which is operating under government auspices and issuing notes which are direct obligations of the United States, banks which, furthermore, by the law, will be the only fiscal agents of the Government and which may hold large Government deposits which might directly be used in the purchase of such bills.

The question, if put in this form, would have been one not to be disposed of by the Federal Reserve Board but rather by those in charge of our national policy. As long as the Federal Reserve Board covered the entire question by the broad provision as outlined under II(c), the question of belligerency and neutrality was not involved. If, however, this clause should be omitted, the banks would have to be prepared to act upon the question of whether or not they should refuse to buy these bills or any bills because they would have been drawn for account of a belligerent.

(The Board in its deliberations also touched upon the question of contraband articles, but it was felt that it was not the Federal Reserve Banks' duty to follow the proceeds of the rediscount operation to this extent and that it might properly be considered as a step of super-arrogation of power if the Board attempted any regulation in this respect.)

It is felt, however, that the Board should be certain that, in outlining its plan of procedure, it should act in harmony with the Government. It is to be expected that whichever way the Board acts in this matter criticism and innuendoes will be directed against

it, and it is important, therefore, that the Board should be certain of its ground and sure that it is carrying out a policy which is in entire harmony with that of the Administration

It was the general opinion that, if, as planned, the Board regulated on the broad lines of sound and well-recognized economic principles, the question could be handled without giving offence to any particular side

The question which is being discussed by the Board in this connection is, should Clause II (c) read, "Such acceptance must be drawn for account of *and* by a commercial firm, etc." In the first case, a bank could not make its acceptance eligible for rediscount with a Federal Reserve Bank if the acceptance was made for account of a government for a government is not a commercial firm or manufacturer or producer. In the second case, a commercial firm by drawing the bill for account of a foreign government would comply with the requirement of the regulation. It ought to be added that the vast majority of such import and export transactions is not done directly for account of foreign governments but by some foreign firms acting as contractors. Any foreign government, by charging a commercial firm with the purchase of the goods, could secure the articles and they could be financed through American acceptances eligible for rediscount. It is only when the foreign government wants to use its own credit in our market and secures accommodation, not as a direct borrower selling its own treasury notes, but by the subterfuge of letting the banker accept and when it secures such credit from the bill market instead of from the investor, that the regulation would act as a preventive

There can be no doubt that the Board acted after the most careful consideration and in full knowledge of all the phases involved in the question

RENEWALS

On June 9, . the negotiations undertaken by Brown Brothers, of New York, for the creation of a \$25,000,000 credit in favor of French banks. There ensued a correspondence certain things that would have to be done in order to bring the transactions within the policy of the Federal Reserve Board. . . there should be in the agreement some reference to the goods which were to be purchased, so as to bring these drafts within the restrictions of the existing regulation, and that it would be necessary to undertake that the drafts should not be renewed after the goods had been delivered to the consignee or purchaser

At a later conference, it might be a matter of prudence to avoid the appearance that any belligerent government was directly connected with the contract to be made with the accepting banks. All of this was in keeping with our policy theretofore pursued. .

Counsel expressed the opinion that it would be advisable to have some reference to the specific goods to be purchased and that, if that

were done, the transaction could be made to come under our regulation, but he raised the point that renewals could not be agreed upon in advance our counsel finally conceded (orally) that he was wrong in his first opinion and that renewals based upon importations or exportations would be permissible for member banks and also eligible for rediscount with Federal Reserve Banks

On July 15, the Board wrote to the New York Bank rendering the opinion that a national bank *could not agree in advance to the renewal of a credit in excess of a period of six months*

Subsequently, there was a meeting of the Board in Washington on August 4

A new letter was then written by counsel to the Board and by the Governor to Mr Strong, of which I received a copy and to which I immediately gave my assent This letter contained the following clause,

"It is hardly necessary to point out that the banks should be scrupulously careful not to devote to such acceptances an undue proportion of their available credit resources, bearing always in mind the necessity of providing for the domestic commercial transactions of the country, very much larger in amount than the foreign trade transactions"

A meeting of the Board was then called for August 10 at New York to finally act upon this ruling of counsel It was at this meeting that radical change of view had taken place

Members showed themselves as eager, not only to grant agreements for renewals, but were arguing and voting for *unlimited renewals even after the goods would long have been shipped and delivered to the purchasers*, and they propounded the theory that Federal Reserve Banks were no more "governmental agencies" than national banks, and that questions of "unneutral acts" should be entirely disregarded

It may be readily seen from the history of the acceptance regulation and the attitude taken by the various members that, up to the meeting of August 10, the negatives had been leaning back at every step tending toward further development, while the positives had been constantly trying to liberalize the interpretation and to widen the scope of operation

While up to that date, as the record shows, it had been due only to persistent efforts that [the negatives] had finally consented to a liberal ruling permitting renewal of acceptances, it developed at the end of that meeting that they were eager to shape the interpretation of the ruling so as to permit indefinite renewals of these drafts without any limitations, even after the goods had been

delivered to the purchaser or consignee. It became apparent also that they had become convinced that it was unnecessary to consider in any way the question of the quasi governmental position of the Federal Reserve Board and the Federal Reserve Banks. They contended that there was no difference in this respect between a national bank and a Federal Reserve Bank.

This change of attitude became even more apparent at the subsequent meetings of the Board on September 2 and 3, when Messrs. [redacted] and [redacted] were willing to adopt in toto, excepting the one clause covering open market operations, the Strong amendments, which, as frankly acknowledged by Governor Strong, had for their purpose to permit finance drafts and also drafts, finance or otherwise, drawn by foreign governments or their agents.

This development was extraordinary because it completely reversed the situation. While, so far, I had been pushing for liberalization so as to enable the country to establish the American bank acceptance as a factor in the world market, Messrs. [redacted] and [redacted], from being negatives changed to ultra positive. That is, they sought to adopt a policy which would disregard important principles heretofore established by the Board and would go beyond the law and the ruling of counsel without giving to their fellow members a plausible explanation for this rather surprising change. They abandoned the principle heretofore adhered to by them that acceptances must be kept within well-restricted bounds, and they were now anxious to open the door wide even for finance drafts. Whereas theretofore they had insisted that the drafts must be of a commercial character, that the goods must be specified and while Mr. [redacted] was very slow in conceding that banks at all might draw such acceptances, they were now eager and, as a matter of fact voted, to strike out any reference to specific goods, and they were willing to permit the construction that, if a draft should be drawn by any bank or government, without any connection or reference whatever to an import or export transaction, that the draft should be considered as based upon import or export transaction, provided only that, when discounted, the proceeds of the bill be used by some third party for the purchase of a check on a foreign country (e.g., in order to pay for pictures bought in London). This would justify us in considering the original transaction as based upon importation or exportation of goods. If the same draft should be drawn and the proceeds should be used to buy a check on London to enable some one to buy a house in London or pay for his traveling expenses to London, the original bill drawn would not have been based

upon importation or exportation of goods, nor could it be so considered if the proceeds had been used for some domestic purpose. Certainly the drawer of the bill in that case would have no knowledge what would become of the proceeds of the bill when he sent it for discount, and the acceptor, who generally has nothing to do with the discount operations, would have a hard time, when accepting, to make sure that the specific proceeds would be sold to a foreign exchange broker who happened to want to sell it to an importing or exporting firm.

CLAUSE (f)

The language of Clause (f) in the Board's regulation of April 2, 1915, was as follows:

(f) A bill of exchange accepted by a "banker" may be considered as drawn in good faith against "actually existing values," under II (c) hereof, when the acceptor is secured by a lien on or by transfer of title to the goods to be transported, or, in case of release of the goods before payment of the acceptance, by the substitution of other adequate security.

Governor Strong . . . insisted on the language a banker's acceptance must be drawn by a purchaser or seller "*or by a banker*." A banker should be permitted to draw, even though he be absolutely free from any connection with an importation or exportation transaction, neither purchaser nor seller, nor agent or banker for the purchaser, in other words, plain finance draft. And a majority of the Board, . . . adopted this point of view . . .

To complete the record, it ought to be added that there was a protracted discussion in the Board concerning the question of whether or not non-member banks—and particularly private bankers—should be required to make to the Federal Reserve Banks or to the Board full statements concerning their financial status.

After prolonged discussions, the latter point of view prevailed, and it was agreed that the acceptance of non-member banks and bankers, if taken without a member bank's indorsement, should be eligible only if such non-members would make statements to the Federal Reserve Bank "in form satisfactory to the Federal Reserve Bank and to be approved by the Board." The restrictionists wished to have "the form *prescribed* by the Board" but finally, as above stated, the more liberal policy prevailed.

It is interesting to note that those who continually had tried to assume for the Board the maximum of supervision and control, to the

extent even of claiming for the Board the power, not only to regulate, but even to administering the Federal Reserve Banks, completely reversed their position when, in dealing with the last amendment, they opened wide the acceptance regulation and left to the discretion of the Federal Reserve Banks questions, not of administration only, but even questions of principle.

CHAPTER XLV

THE FIRST PERIOD OF DEVELOPMENT¹

Effectiveness of Organization

The question, how satisfactorily the new type of banking organization had operated in the first period of development, is difficult. It is not enough to be clean or free of partisanship, a business organization must be efficient as well. In essence, the Federal Reserve Act sought to eliminate red-tape administration by placing within the hands of the several banks the actual work of practical banking, leaving to the Federal Reserve Board itself only those general duties and that exercise of supervisory authority which can be maintained with a small staff of trustworthy employees. The Federal Reserve Board from the beginning of its existence perceived the possibilities of this arrangement, and from the outset sedulously strove to abstain from interference with routine business at the several banks, with the selection of personnel, or with any matter which could properly be placed in the hands of the banks themselves. This policy resulted in the choice by the several banks of their own staffs, wholly free of interference on the part of the Federal Reserve Board, although the Board, in the case of the higher officers, freely gave its advice when requested. The Board not only chose its own staff without reference to political considerations, but made the choice under a system of selection as rigid and careful as that employed by the Civil Service Commission. A number of employees who had been chosen by the Reserve Bank Organization Committee were transferred automatically to the staff of the Reserve Board, but in this

¹In the first part of this chapter (pages 1031 ff) large use has been made of an article on "The First Year of the New Banking System," by the author (*Political Science Quarterly*, Dec., 1915).

transfer the Board merely accepted what it found. Its own selections were made in the way already indicated. The Board, moreover, largely reduced the size of the staff employed by the Organization Committee, and, as compared with other government bodies, its expenses would unquestionably be considered very moderate. At the several banks efforts had in most cases been made to keep expenses to a reasonable level and to avoid employing supernumeraries.

Businesslike Management

From the larger standpoint, also, the general working of the organization had, in the main, been effective. Shortly after the banks were opened, there was a period during which action upon the numerous questions presented to the Federal Reserve Board was not immediate, owing to the fact that many factors still had to be ascertained and much information collected concerning conditions in the several districts. Without due investigation, any ruling that might have been issued would have lacked uniformity and would probably have been subject to extensive change at a later date. The delays which then occurred, therefore, may be regarded as unavoidable, and they were for the most part soon eliminated. In fact, it was the testimony of many who were directly affected by the Board's work that it had succeeded in obtaining unexpectedly prompt action, and had avoided delay to a degree that had enabled the banks to act with at least reasonable speed upon the applications of their customers. As for the banks themselves, there was at first in the minds of many of their members the thought that they—like the Board—would be red-tape institutions, operated under such conditions that business men could hardly hope to get accommodation from them save in times of necessity and under conditions that would not make it worth while for them to attempt the maintenance of regular relations. This prediction, wherever it was made, had failed of verification. Not a few of the federal reserve banks had done exceptional

educative work in explaining to their members what they had to do to secure prompt and effective attention in their application for rediscounts. All this had taken time but in many instances the service rendered by the reserve banks was prompt and satisfactory as that rendered by the larger correspondent banks of the cities, and there was no reason why a member bank possessed of discountable paper could not confidently count upon the accommodation that it desired, without undue delay and at a minimum of expense.

In the relations between the several banks and the Federal Reserve Board, there had been difference of opinion upon points involving current operations. These divergences had been of minor importance except as to the question to what extent the weekly discount rates might be considered under the direct control of the Federal Reserve Board. Whatever doubt had properly been entertained on this point had, however, been dissipated by the definite position assumed by the Board to the effect that discount rates could not become effective without its approval, and that the scope and purpose of the act, as such, undoubtedly gave it the right to make suggestions as to the general discount policy of the several banks.

Rate of Discount

Perhaps no one feature of the Federal Reserve Act had received so much attention prior to the organization of the new banks as its provisions regarding the rate of discount. During the agitation for the Aldrich or Monetary Commission bill, much had been said of the supposed necessity of developing a uniform rate of discount applicable to the whole country. The Federal Reserve Act was framed upon the theory that such a uniform rate of discount was neither practical nor desirable for a country possessed of so great an extent of territory as the United States, and containing within itself so many different industrial conditions and such widely varying demand for, and supply of, capital.

Briefly stated, the situation as to discount rates throughout the country had previously been as follows. A small number of large banks, most of them situated in New York, and some in other large cities, had made a practice of developing the discount business for banking customers. Themselves designated as "reserve agents," they had held the reserves of the other banks of the national system, and had attempted to develop their own resources upon central banking principles. How far they succeeded may be realized from the fact that one institution had had at times about six thousand country correspondents, national and state—that is to say, other banks holding business relations with it, and in most cases depositing a part of their reserves with it—while others had at times had nearly as many. Some competition had existed between these large banks, but "banking ethics" had prevented an undue development in such a direction. In consequence, rates of discount had been fixed practically upon the basis of what the traffic would bear, and loans had been made practically upon a collateral system. On this basis, rates had varied widely, and, on the whole, had been high, at times, however, they had been very low, if conditions were such as to lead the city banks to push out more funds into current use.

The organization of the federal reserve system changed the situation in two ways. It offered to the banks of the country the opportunity of obtaining rediscounts by actually presenting specific items of paper, not as collateral but for the purpose of obtaining a bona fide rediscount in each and every case. Further, it had established throughout each federal reserve district a definitely known rate of rediscount, published periodically, and available to all member banks upon exactly the same conditions. The effect of this change had been important. It had tended to bring about the standardization of rates by city banks on a level substantially similar to that fixed by the federal reserve bank in the district in which the rate was offered. It had thus given to borrowing banks a standard of comparison which

in the past they had never possessed. They now knew that by going to the federal reserve bank with a given, carefully described kind of paper, they could get 30-day accommodation at, say, 4 per cent. In the past they had usually learned from their financial journals that "prime" commercial paper could be disposed of at, say, 4 per cent, while "good to fair" was considerably higher, but they had too frequently found, when presenting their paper, that it was of the good-to-fair variety, and as such necessitated the payment of the higher rate. Discount rates throughout the country had undoubtedly been abnormally low since the autumn of 1914. The Federal Reserve Board had recognized this fact, and had constantly endeavored to avoid making them lower than they should have been. It was therefore impossible to say as yet whether the effect of the federal reserve system had been the much desired lowering of rates of interest. What is certain is that the banks had their discounts at a very low rate, and that they had obtained these discounts under standard conditions that they probably could not have hoped to obtain without the new system.

All this, however, had had to do merely with the rate of interest paid by one bank to another. What the public was prone to inquire was whether the new system had succeeded in reducing the rates to the customers of the banks. To this it might be answered that anything that resulted in reducing the rate of interest a bank had to pay, tended in due time to reduce the rate of interest it could charge. Further, the fact that individuals knew that their bank was able to rediscount a given note at, say, 4 per cent, necessarily made them unwilling to pay an excessive advance over that rate. Business men who understood that their paper fell within the requirements of the Federal Reserve Act, were able to demand, and did in practice exact, a rate on such paper corresponding roughly to the rate fixed by the federal reserve bank plus a moderate commission. Some of them had been able to discount their paper below that rate because their own banks were holding

high reserves and were eager to get business. Had the conditions been reversed, and had severe stringency been prevalent, they would have been able to demand accommodation from their banks based upon the rate charged by the federal reserve bank of the district. The effects of the federal reserve system upon the large business man, or the business man irrespective of size, who knew how and was able to make his paper coincide with the requirements of the Federal Reserve Act, had been already perceptible and important. The effect of the act upon other borrowers whose paper was not eligible to rediscount had probably been very much less. In time it was to be expected that every borrower would get the indirect benefits to which he was entitled under the law, but this was a matter involving banking competition, and requiring a relatively long period for its application.

Open Market Provision

The Federal Reserve Act, however, had made provision for a system whereby the benefits of the law could be definitely conveyed to the public at large whenever circumstances permitted. This was found in the open market section (Section 14) of the law. As originally drafted, Section 14 provided that federal reserve banks might buy in the open market notes, drafts, and bills of exchange of the kind which had been made eligible for rediscount. The provision was subsequently emasculated so as to apply only to bills of exchange and cable transfers, but the bills of exchange provision alone would have been sufficient to insure a very large circle of transactions between federal reserve banks and the people at large, based upon the actual sale of goods, and without the intervention of any member bank. This provision was necessary from a strict banking standpoint for the purpose of enabling the reserve banks to make their rates of discount effective—that is to say, to insure the extension of rates similar to those which they themselves were charging. The reserve banks had

been advised by official circular under what conditions they might proceed with such transactions but few had acted on the suggestion. The open-market provision therefore (except as it related to municipal warrants, acceptances and bonds) remained largely inoperative. It was undoubtedly one of the most important provisions in the act and forms the means whereby the benefits of the federal reserve system might, if desired and permitted, be carried immediately beyond the limited circle of banking customers without waiting for the slow effect of indirect competition.

One aspect of the question as to how far the so-called "small man" had obtained benefits from the reserve system, might be better understood from an analysis of the paper discounted by federal reserve banks, according to the size of the note. Such an analysis is presented in the table on page 1040, and from this it is clear that loans of the smaller class had greatly predominated. A reason why this had been the case was that theretofore the business of federal reserve banks had been almost wholly with the smaller institutions among their members. In those districts where the rank and file of the members were banks of small or moderate capitalization, the business of the reserve banks had been much more active than in those where the bulk of the capital was in the hands of a few very large banks. As is suggested by the table, the large banks had, to a considerable extent, stood aloof, partly, no doubt, because their reserves were high and they did not need to seek accommodation outside of their own vaults.

Attitude of Members

It was, however, both an interesting and a regrettable factor in the present situation, that a certain number of the city banks had been inclined to regard the federal reserve banks as competitors of their own, likely to draw the country banking trade away from them, and consequently to be more or less quietly opposed in their operations. Coupled with this had

been the fact that few well-managed city banks had been in position to require any assistance themselves. The consequence had been that the business of several of the reserve banks during the first year of their existence had been, to an extent that would probably never again be duplicated, confined to dealings with country banks in more or less difficult circumstances. There were exceptions to this statement. Some prosperous and able bankers, including a few who did not need any accommodation, had deemed it wise to become customers of federal reserve banks for the purpose of keeping the machinery in working order, or of showing good-will, or of, incidentally, clearing a neat profit for themselves, as in the case of one large bank which retired its interest-bearing clearing-house certificates by discounting at a lower rate with a federal reserve bank. These cases, although more or less numerous, were, however, as already stated, the exception. The efforts of the federal reserve system in the aggregate had therefore been devoted largely to the relief of the small country institutions.

This had been in many ways a service of exceptional merit. During the year after the opening of the new system, there had been remarkably few bank failures, as against the heavy crop of failures which had usually succeeded past periods of stringency and difficulty. Undoubtedly the federal reserve system had done well in preventing bank failures—how well would be only a matter of opinion even on the part of those intimately conversant with the situation in each district. While recognizing this situation, the student of banking would, however, naturally inquire whether in fact the federal reserve system in its future operations was likely to confine itself largely to dealing with hard-pressed members. In answering this question a great deal had to depend upon the extent to which the banks entered the open-market field, and the extent to which individual business men consented to sell their paper in the form of bills of exchange available for purchase by reserve banks under the open-market section of the law. It

COMMERCIAL PAPER, EXCLUSIVE OF BANKERS' ACCEPTANCES, REDISCOUNTED BY EACH OF THE FEDERAL RESERVE BANKS DURING THE MONTH OF AUGUST, 1915, DISTRIBUTED BY SIZES

NUMBER OF PIECES AND AMOUNTS

(Figures opposite federal reserve centers are given in thousands of dollars)

BANK	to \$100		OVER \$100 to \$250		OVER \$250 to \$500		OVER \$500 to \$1,000		OVER \$1,000 to \$2,500		OVER \$2,500 to \$5,000		OVER \$5,000 to \$10,000		TOTAL		PER CENT			
	Number of pieces	Amount	Number of pieces	Amount	Number of pieces	Amount	Number of pieces	Amount	Number of pieces	Amount	Number of pieces	Amount	Number of pieces	Amount	Number of pieces	Amount	Number of pieces	Amount		
Boston			9	1 1	31	12 3	26	18 0	15	18 7	5	20 6	1	5 1	1	18 0	84	75 8	0 9	0 6
New York	10	0 8	16	3 0	36	14 2	33	23 6	23	40 6	6	20 1	5	37 5	1	132	132	0 1	1 3	0 6
Philadelphia	22	1 5	31	5 5	29	10 5	17	13 3	52	90 8	69	317 7	27	242 1	5	236	786 0	2 6	6 5	0 5
Cleveland	41	7 2	41	7 2	68	26 9	57	40 7	40	88 0	32	1,320 3	78	612 0	17	280	3,073 6	33 7	32 5	0 5
Richmond	371	2 90	574	103 3	683	269 8	573	407 9	305	542 9	192	774 3	43	321 0	15	53 116	2,529 8	19 7	19 0	0 5
Atlanta	240	16 9	378	65 9	362	138 2	203	229 6	305	542 9	192	774 3	43	321 0	15	53 116	2,529 8	19 7	19 0	0 5
Chicago	2	3 3	7	1 4	37	15 8	39	31 0	38	101 9	22	85 6	10	66 8	8	175	305 3	1 0	2 5	0 5
St. Louis	40	3 0	87	15 0	95	36 0	72	55 7	78	132 0	29	130 1	24	169 2	1	20 0	303	1 0	4 5	0 5
Minneapolis																				0 5
Kansas City	27	2 0	117	20 1	143	59 9	145	103 4	107	166 2	40	134 4	10	116 5	2	21 6	341	3 1	4 1	0 5
Dallas	117	7 6	459	76 4	406	149 5	322	228 3	318	501 6	160	601 2	53	346 0	6	78 7	754	7 1	6 3	0 3
San Francisco	1	1 1	35	5 5	40	14 8	39	27 6	58	91 4	37	135 8	13	89 0	6	134 0	2,044 6	20 1	10 7	0 3
Total	830	61 2	1,811	313 1	1,938	740 1	1,654	1,266 7	1,692	2 876 3	951	3,776 9	298	2,173 6	66	1 025 8	12 233 7	100 0	100 0	0 0

PERCENTAGES OF AMOUNTS OF EACH CLASS TO TOTAL

Boston																				
New York	0	1	16	23	24	27	27	6	11	100	0	100	0	100	0	100	0	100	0	100
Philadelphia	1	0	0	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
Cleveland	2	6	3	6	6	10	10	10	10	10	10	10	10	10	10	10	10	10	10	10
Richmond	7	7	3	11	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22
Atlanta	7	7	3	11	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22
Chicago	1	1	5	10	10	33	33	33	33	33	33	33	33	33	33	33	33	33	33	33
St. Louis	5	5	3	10	10	33	33	33	33	33	33	33	33	33	33	33	33	33	33	33
Minneapolis	5	5	3	10	10	33	33	33	33	33	33	33	33	33	33	33	33	33	33	33
Kansas City	3	6	6	13	32	32	32	32	32	32	32	32	32	32	32	32	32	32	32	32
Dallas	4	3	7	11	29	29	29	29	29	29	29	29	29	29	29	29	29	29	29	29
San Francisco	1	3	3	0	2	20	20	20	20	20	20	20	20	20	20	20	20	20	20	20
Total	5	26	60	104	235	309	309	177	84	1000	0	1000	0	1000	0	1000	0	1000	0	1000

would probably be some time before large city banks, heretofore in the habit of doing a substantial part of their business with country bank customers, would consent to abandon this trade, even in part, and a still longer time before they would habitually resort to the federal reserve banks themselves. It must be a matter of education and also of development to induce them to do so. Meanwhile the federal reserve banks could look to open-market operations as a means of enlarging their business beyond the confines of mere assistance to members who found themselves obliged to seek aid.

However, the tendency of the reserve banks, under the existing conditions, to deal largely in paper of small face value, was illustrated by the comparison already furnished which shows that nearly one-third of all paper discounted was in notes varying from \$2,500 to \$5,000, and nearly one-fourth was in notes between \$1,000 and \$2,500, less than 9 per cent of the notes (taking August as a representative month) were over \$10,000 each, while a substantial percentage of all was under \$500. The comparison, moreover, undoubtedly afforded a conclusive reply to those who had alleged that the resources of federal reserve banks were being used simply for the promotion of the interests of city banks.

Massing the Reserves²

The first and foremost function of the federal reserve system was, in fact, that of massing the reserves of the country in a small number of places. This is a process which had not been fully accomplished, but which was approaching completion. The federal reserve banks were, by June 30, 1916, the holders of \$404,206,000 in money, while the reserve and central reserve cities of the country were the holders of \$524,147,000. Prior to the organization of the federal reserve

² The following pages of this chapter are in large part taken from a survey made by the author in 1916 for the Governor of the Federal Reserve Board.

system there were \$633,861,000 in the banks of the reserve and central reserve cities. No reasonable comparison between the figures existing before the organization of the reserve banks and those that were applicable two years later was possible, for the reason that industrial and financial changes had been so great during the period in question, while bank deposits had been so long subjected to the influence of external changes of various kinds, that to attempt to isolate the effect of the reserve system upon these holdings of cash would have been out of the question. What we can say with certainty is that in 1916 there was a centralized and efficient system of reserves available for the purpose of meeting the necessities of member banks in case of need.

In the beginning there was great fear on the part of many bankers that the transfer of reserves would be accompanied with serious suffering and loss to them. The figures already given (page 1040) show that no such suffering or sacrifice had occurred, but that on the contrary the prosperity of the member banks had advanced step by step with the progress and development of the federal reserve system. Provision for a great system of reserves, amounting to \$404,206,000, and of whose efficacy there could be no doubt in any mind, had taken place without involving any loss whatever to the member banks, by the use of whose resources this reserve had been built up. The provision of this reserve, with all that it meant in the way of safety and in the elimination of unnecessary and expensive methods of doing business, was the first and fundamental achievement of the new system. It was the point at which the new system touched the experience of other countries by attaining the object which had universally been found necessary by advanced modern nations—the establishment of an effective central system of credit accommodation available for the conversion of bank assets into immediate means of payment.

Elastic Note Issue

Closely in conjunction with the foregoing advance is to be reckoned the provision of an elastic note currency. The federal reserve system had beyond any question provided an adequate method for supplying a circulating medium of exchange based upon business and depending for its volume, in theory, on the quantity of business transactions undertaken in the country at a given time. By the middle of 1916, there was outstanding in circulation about \$220,490,000 of federal reserve notes, and behind them there were held by federal reserve agents \$204,476,000 in gold coin, and \$16,220,000 in commercial paper. The federal reserve banks themselves had, however, the sum of \$101,094,000 in commercial paper, while their resources were such as to enable them to discount for member banks an almost unlimited quantity of commercial paper held by these banks in their vaults. The notes that had been issued, therefore, merely indicated the method by which currency might be obtained from federal reserve banks when desired, and furnished no indication whatever of the relief that might be expected through this means when the machinery of the system was fully called into play. Limited as it had been, the experience so far had shown that the machinery for the issue of notes furnished by the Federal Reserve Act was, so far as rules allowed, adequate, and that there could be no reasonable doubt that at any time of stress or difficulty when the system might be called upon to render such service, it would be able almost instantaneously to meet the requirements of those who might call upon it for assistance through the medium of note issue.

Effect on Commercial Paper

In spite of the errors already sketched in former chapters, the federal reserve system had done much to standardize the commercial paper of the country. The circulars and regulations of the Board, whatever criticisms might be passed upon

them, supplied the only authoritative and general definition of commercial paper of the various kinds that had been available in this country theretofore while the efforts of the federal reserve banks to secure the co-operation of member banks and their borrowers in putting their paper into a form likely to correspond with the rules of the Board, had been the first organized attempt to bring about uniformity of practice and unanimity of action in the direction desired. That the action thus taken was already having an important influence in bringing about the standardization of accounting and uniformity in the definition of various commercial terms, could not be questioned. The system, therefore, must be credited with having taken the first really practical step in a direction long desired by theoretical reformers and practical business men—that of unifying the business practices and commercial paper of the country, and of providing a basis for the extension of credit on a recognized and established foundation.

The Discount Market

Likewise growing out of the centralization of reserves and the standardization of commercial paper, was the work done by the reserve system in bringing about what is called a "discount market." This discount market was the product partly of the standardization of paper and partly of the creation of new forms of paper, such as the bankers' acceptance, available for the financing of international transactions. It was partly also the outcome of the actual operations of the reserve banks themselves with their established and publicly posted discount rates.

The federal reserve system had also operated very strongly to the reduction of the rates of interest upon commercial paper of known value. It was estimated by some that this reduction amounted to perhaps 1 per cent, but whether more or less than this, it was undoubtedly true that such a tendency to reduction had occurred and that it would continue to

operate as time went on and as circumstances warranted its further evolution. This did not mean a loss of profit to any member of the community. As is well known, the rate of interest is made up of three distinct elements—the one providing a return for the labor and investigation required for the analyzing and carrying through of any particular operation, the second providing the remuneration necessary to induce owners of capital to part with it, while the third provides a fund to be used as an insurance against risk. The reduction of the rate of interest by federal reserve banks was in part a reduction in the latter element of cost, that is to say, a lowering of the risk element in it merely meant that the federal reserve system had provided a method for recognizing and guaranteeing unquestionably good paper, and for adjusting the rate of interest on such paper so that it more nearly corresponded with the actual sacrifice involved in advancing money on it. It formed, in other words, a method whereby the legitimate and conservative borrower could obtain accommodation at a rate corresponding to what he had to offer, and was relieved of the necessity of paying more, as shown, in view of his own responsibility and solvency. The advantage of this reduction had been distinctly recognized by those small business men who, in the past, had been unable to obtain the low rate of interest to which their business uprightness and efficiency entitled them, notwithstanding that they were conducting their operations upon such a basis as to warrant the extension to them of the best and cheapest credit the community could afford.

Growth of Business

While thus meeting the needs of the general public and of the financial community at large in many and important ways, the federal reserve system had also rendered a direct and important service to the banks themselves in enlarging their opportunities for profit. In this connection the system had

opened to the national banks three distinct avenues of business previously closed. It provided for the making of acceptances by bankers, and had thereby enabled them to profit greatly through the use of their credit, particularly in transactions involving international operations. Second, it had, through its provisions for the extension of fiduciary powers, enabled many banks, particularly those of the smaller capitalization, to undertake functions previously forbidden to them, but which in many communities they could conduct to the great advantage of their customers as well as of themselves. Finally the act had enabled a large proportion of the member banks to make direct loans under safe and conservative conditions based upon real estate, thereby permitting the extension of accommodation to farmers in a degree and under conditions that were previously not available. This had undoubtedly been to the benefit of the agriculture of the country, but it was also greatly beneficial to the bankers themselves from the mere standpoint of profit and of security.

Special Services

In a variety of special ways the reserve system had been of very large and immediate service. The assistance rendered by it in connection with the distressing conditions surrounding the cotton-growers of the South shortly after the opening of the European war, has been earlier reviewed. By the application of various appropriate methods, the Federal Reserve Board and the banks located in the southern states had succeeded in allaying the alarm felt in those states, and in materially improving the general business conditions there, ultimately thereby aiding in the restoration of normal prices for cotton. Like service had been rendered in connection with other businesses and in other portions of the country, for the work of the Board had at no time been sectional, private, or exclusive. It had stood ready to relieve to the utmost of its ability difficult conditions wherever they might be developed, and in this duty

it had succeeded in a very marked degree, not merely in the cotton states, but at a number of other points. It had never been necessary for one federal reserve bank to call upon another for assistance through the placing of rediscounted paper with that other, but the Board had always been ready to facilitate such transactions and to throw the strength of the entire system forward to the support of any particular section of the community that might find itself attacked. The fact that no such action had been needful was a strong testimony to the sound working and beneficial influences of the system itself, but it is worth while to note that the machinery for this kind of relief had always been available and in working order.

Support of Foreign Trade

The federal reserve system had also played a limited part in connection with the new development of foreign trade. In all, 44 banks had been authorized to accept up to 100 per cent of their capital and surplus, and it was estimated that the volume of drafts in the foreign trade accepted by American banks and bankers was about 175 millions. This, however, was but one element in the business. As is well known, many state institutions hastened to follow the example of the federal government by according their own institutions authority to undertake the business. In consequence an acceptance market of some scope had been developed outside, as well as inside the reserve system.

The service rendered to foreign trade, moreover, had been larger through indirect than through direct channels, although both were equally the outcome of the new system. Shippers in foreign countries, desirous of continuing or expanding their business with the United States, had secured the aid of American banks, and had opened accounts with the latter. In some cases, American banks had agreed to meet drafts drawn upon them, such drafts being protected in case of necessity by American securities held in trust, and simply hypothecated

whenever conditions required it, in order to restore the balance of the foreign drawers. In other cases, a credit had been established and maintained against warehouse receipts representing commodities stored in foreign countries, and ready for, or in process of, shipment to the United States, as circumstances demanded. Still other classes of accommodation had been arranged according to the convenience of foreign dealers and the facilities of American banking houses. The outcome had been that of transferring to the United States a considerable part of the actual work of "carrying" commodities in transit to and from this country—a burden formerly borne by banks in London and other European markets. A circumstance which had greatly aided in this process had been the increasing inability of foreign banks to continue to furnish the accommodation which exporters had been in the habit of receiving from them.

Work Still Remaining

Several of the provisions of the Federal Reserve Act were still incompletely applied, or had not yet been called into play at all. The federal reserve system was only a beginning of something which, if properly carried out, would transform the banking system of the United States. Future lines of development of the system were evidently three in number:

- 1 The completion and strengthening of the activities already undertaken
- 2 The full and detailed application of all the essential provisions of the Federal Reserve Act
- 3 The creation and development of an influential part in the banking life of the country

The original and basic idea of the act was that of the transfer of reserves from the reserve-holding banks of the cities to the federal reserve banks. This process had not been completed, and could not be for a year to come. Congress had, by amendment to the Federal Reserve Act, rendered the

process of transferring the reserves from the member banks to the reserve banks a very much easier and more natural process than it would otherwise have been, but there still remained the work of breaking off the older relations with the city reserve correspondents, and of definitely transferring the reserve holdings to the reserve institutions. The importance, not to say the necessity, of doing this promptly in order that the reserve banks might be strong and able to exert their full functions when the return movement of gold from the United States to Europe set in, had been amply recognized. Even when the complete legal transfer of reserves had been made in the way provided by law, the question still remained how far the member banks of the country would go in strengthening and building up the gold holdings of the reserve banks by voluntarily transferring to them the excess reserves.

Membership

The history of the membership of the reserve system had passed through several periods. At first there was an apparently general disposition on the part of state banks and trust companies to accept membership. This was followed by a period of indifference. Later a new attitude seemingly set in, some strong state institutions having become members of the system, while others were carefully considering the steps to be taken with a view to membership. There had been no such general application for admission to the system as was necessary in order properly to round it out, and to make it an inclusive organization comprising practically the bulk of the strong commercial banks of the country.

Closely allied to this matter was the question of the clearing and collection of checks. The federal reserve banks had made a beginning in the installation of a complete clearing and collection system, and were doing good work along lines which were certainly conservative and legal. As yet they were, of course, collecting only a small fraction of the exchanges

of the country. Their service in this regard would have to be greatly enlarged if they were to perform their whole duty and render their best service to the business public. The further expansion and application of the clearing and collection system was, therefore, one of primary lines along which future development had to proceed. This development would inevitably result in enlarging the profit and improving the condition of all of the banks which became parties to it. It was not a plan for unfair reduction of earnings or for the crippling and curtailment of their various activities. It was designed to help and not to hurt them. But in this new and undeveloped field much remained to be done, and much experimentation was necessary before the best way of applying the new methods to the advantage of all and without injury to any could be found.

Activity of Reserve Banks

The question also remained whether the reserve banks would be able to naturalize themselves, so to speak, as practical, living members of the banking community, doing a regular banking business, day in and day out, of meeting a regular and sustained demand, and making a steady profit as a result of their work. Their earnings were not being made in the main through rediscounts or the purchase of commercial paper, and the question was one to be settled how soon the reserve banks would be able to derive their principal income from regular operations in business paper growing out of practical trade operations. They might have been greatly assisted in the attainment of this object had they entered the field of foreign exchange from which they had been debarred largely as the result of unsettled condition of exchange in Europe. But in the meantime there was a large domestic field to be covered by the banks in establishing their true place in the commercial paper market. The task of occupying this place was urgent, not merely because of the question of earnings and expenses of the banks, but because the true function of a reserve bank

to the rate of interest and the general discount market of the country could not be performed unless the bank was a live factor in the market of the country. How far the actual practice of rediscounting would be developed at an early date by the member banks was still to be seen.

But while awaiting this development, and particularly in case it should be unexpectedly slow in arriving, the banks might still become factors of importance in the general open market for commercial paper. To take up this branch of business permitted by the regulations of the Board, but only engaged in to a limited extent, implied the working out of a comprehensive system of credit information, and the establishment of relations with various agencies through which information of the desired kind could be secured. This process would take time and involve a considerable amount of executive and business skill. It was, however, a matter that could safely be entrusted to the individual reserve banks. This branch of the system's development opened a large field of activities.

Exchange Operations

In important particulars the Federal Reserve Act had not been applied at all. Of these, perhaps none was so important as the section which had to do with foreign exchange and foreign business in general. The Federal Reserve Act made full provision for the creation of branches of member banks abroad, and also for the establishment of agencies of federal reserve banks. Precisely what the functions of these agencies were to be, and the nature of their relationship with the branches of member banks as well as with other banks and banking institutions, had not been determined inasmuch as no branches of federal reserve banks had been undertaken. There was a large field of important work still to be covered by the federal reserve system in this connection before the federal reserve banks could be said to have even approximately

discharged the duties and responsibilities imposed upon them by the act. How great the importance of this phase of their activities might be, could be judged only by those who had formed an adequate conception of the probable part to be played by the United States in international trade after the war was over.

Fiscal Business

The development of the fiscal side of the business of the banks was likewise still in its infancy. Under the terms of the law the reserve banks were the fiscal agents of the United States government, a duty which thus far they had discharged only upon a limited basis. It was to be expected that in the future financing of the United States the system would gradually assume the duties of providing for such issues of bonds, retirement and refunding of existing indebtedness, and such other financial operations as might be necessary from time to time. It would extend its scope in the handling of the daily business of the Treasury and sub-treasuries as the banks became better and better able to render this service and as the other functions exercised by fiscal branches of the Treasury were gradually transferred to them. In other ways there still remained important fields to be covered before it could be asserted with any reasonable assurance that the Federal Reserve Act was completely and fully in operation.

CHAPTER XLVI

CLEARANCES AND TRANSFERS

Origin of Problem

One of the most difficult problems of the federal reserve mechanism that had been offered to the Board for treatment, was found in the provisions relating to clearances and transfers. At another point attention has been given to the general question of an interdistrict clearing system as embodied in what came to be called the "Gold Settlement Fund," but nothing has been said of the local or district transfer question. In Book I, when tracing the evolution of the Federal Reserve Act, it was shown why the par collection and clearing house provisions were introduced into the measure at a comparatively advanced stage of its history. As was seen at that time, the reason for calling for par collection and for requiring each reserve bank to act as a clearing house for its members, was found in the fact that only in this way did it seem likely that the federal reserve system would ever attain its full stature or would succeed in getting a regular flow of business to and from its member banks.

History of Section of Law

The provisions had not been incorporated into the first draft of the Federal Reserve Act, partly because at that time it was believed that extensive open market provisions could be embodied in the measure. As the struggle over the passage of the act proceeded the difficulty of keeping such provisions in the law made itself apparent and accordingly the elimination of any except a comparatively limited open-market section was

regarded as probable. With this in view, it was believed that success was not likely to come to the measure in ordinary operation unless some means should be provided for keeping the reserve banks regularly and steadily engaged, even in time of slack discounting, and for insuring a regular flow of items into and out of their vaults, thereby making the reserve balances with them a tool of trade and not merely a dead or idle fund held in banks for possible emergencies.

Nevertheless, it had not been supposed that the introduction of the system in actual practice would prove easy. Even while the measure was on its way through Congress, it had received the general and severe opposition of country banks who had specified the par collection provision as particularly distasteful to them. They had demanded that this provision be eliminated, and they had so far succeeded that in the Senate they were able to secure a modification of the provision. Nevertheless, in conference committee the par collection clause had been restored in approximately its original form, so that when the Federal Reserve Board took office it found itself subject to the necessity of putting into effect at some comparatively early date a system whereby actual clearing house work would be done by reserve banks, and whereby members would be encouraged to deposit with them regularly the checks and drafts drawn on other members which they received.

Opposition to Provision

The Board, however, had hardly organized when the opposition to this provision, both within and without its membership, became very pronounced. Country bankers were against it because they saw that, notwithstanding there was nothing in the Federal Reserve Act to compel a bank to furnish exchange free of charge to its customers, the tendency of a par collection system which operated as between banks would eventually be to transfer the benefit of the service to the customer. Recognizing this fact and realizing that a large proportion of their

own earnings were derived from exchange, the country banks were, as a mere matter of self-interest, opposed to par collection. On the other hand, the par collection idea was obnoxious to city banks, many of them believing that without this they would be able to offer a competing service to the country banks which would enable them to hold deposits from country correspondents, while they thought that if the reserve banks took over the par collection services as proposed, it would be almost out of the question for them to retain their own deposits untouched even during the three-year period which had been allowed for a complete transfer of reserves. They accordingly undertook to oppose the idea in toto and there was evident from the beginning a very strenuous disposition to discredit the whole notion and to contend that it was unsound or unworkable. These ideas were strongly impressed upon the governors of reserve banks and took root in their minds to such an extent that in early conference with the Federal Reserve Board, during the autumn of 1914, some of them assumed a position which appeared to be almost equivalent to a refusal to introduce par collection.¹ This conference, however, proved only an introductory step in the discussion. It was followed by many other conferences during the winter of 1914-1915, at which the difficulties of the case were urged, and at one time it was proposed that the whole subject be laid on the shelf or referred to Congress for clarifying legislation. Nevertheless the views expressed at the first session furnished the keynote of the entire debate.

Nature of Objections to Par Collection

The nature of the objections to par collection should be carefully noted, not only for their own interest but because the subject is still one which is before Congress for the purpose of readjustment. Perhaps the first and basic objection that was

¹ Attached as Appendix A to this chapter is a statement of the views expressed at the conference in question. These are given at some length because of the light they throw on the history of the collection system.

offered came from within the Board and was presented by way of an opinion of the Board's counsel, who held that it was not possible for reserve banks to receive from their members checks and drafts drawn on other members, and to charge them off against the accounts of the latter until the latter had first seen and acknowledged such claims, at the same time authorizing them to pay. As to this question opinion differed widely not only among the practical bankers of the system but also among legal authorities. The opinion of the Board's counsel has always been the subject of more or less controversy but was hesitatingly accepted as valid, the Board thereupon reconciling itself to the necessity of coping with the plan even under the handicap that had thus been imposed upon it from the legal standpoint.² It is interesting to note at this point that in some way this opinion of counsel almost immediately became semi-public, being distributed among the reserve banks and among others who were interested in the situation notwithstanding that the counsel himself had never issued it.

A second objection to the plan was found not in any legal phase of it, but in the assertion that the collection system sought to be established by the Federal Reserve Act was uneconomic inasmuch as that system apparently called for immediate debit and credit—the check being credited to the depositing bank as soon as received and charged off against the reserve account of the member on which drawn at the same time. This uneconomic character was said to be found in the fact that such immediate debiting and crediting necessarily resulted in the creation of demand obligations payable prior to the time that the funds had become "available." Or, to put the case in another way, if Bank A deposited with Federal Reserve Bank No. 1 a check for \$100 drawn on B, which was at once credited to A and debited to B, some time must elapse before the information of this debit entry could be conveyed to B. During that

² Probably the first expression on this subject was given by the counsel in a letter of Jan. 4, 1915, reproduced in Appendix B to this chapter.

lapse of time B would suppose itself to be fully in possession of its unimpaired reserve balance and would continue making loans or drawing on account just as if the check had not been debited to it. Of course, this view entirely ignored the fact that practically as many checks would be drawn in favor of B as against B, and so on throughout the entire aggregate of banks, so that the effect of the immediate debit and credit would simply be to cause the transfer of ownership without creating any additional "float." The argument, however, of the uneconomic character of the proposal attained a wide acceptance and was nowhere stronger than within the Board itself.

In addition to these arguments was the further, although less popular, contention that the effect of having reserve banks act as clearing houses through the par collection system would practically amount to a destruction of the older clearing houses, which would wane in importance and eventually would be forced out of business by reason of the fact that there would be nothing for them to do. As is well known, the clearing house influence in many of the larger cities had always been very powerful and the local clearing house has frequently exerted an influence which had little or nothing to do with its actual professional operations, being primarily directed to the general oversight of the banking community, the establishment of standards of conduct among the banks, and the repression of methods or practices that were deemed undesirable.

First Result of Controversy

Although the Board never inclined in any open way to give much weight to the clearing house argument, so that it would be difficult to judge exactly what force was really acquired by that line of thought, it is unquestionably true that the other two phases of the argument strongly appealed to members, so much so that there was great hesitation about proceeding. A sharp rift developed among the members, one group taking

the position that the clearing house and par collection section was desirable, not to say necessary, and that the reserve banks should be encouraged to put it into effect fully, the other group taking the view that the provision was one of the dangerous and radical notions which had found their way into the Reserve Act, and that it should so far as practicable be limited in operation, all of the reserve banks being subjected to uniform rules and regulations to be laid down by the Board. This latter group undoubtedly overreached itself by putting its case too strongly.

Very soon after the organization of the system had been tentatively completed, the reserve banks of St. Louis and Kansas City had expressed a wish to adopt a complete system of par collection, and were eventually permitted to do so by the Board. They had installed such a system in those two districts and considerable progress was being made in the application of the method, at the same time that report was being sent to the Board from the eastern districts that the notion was wholly impracticable and out of the question. Not only was this true but there were apparently members of the Board who would have preferred to see the St. Louis and Kansas City experiment unsuccessful and who from time to time reported unfavorably with regard to its progress or what they had heard with reference thereto.

History of System in the Southwest

The St. Louis and Kansas City clearing systems continued in an isolated way but never attained full success, largely because of the fact that they never succeeded in becoming a part of any general whole. It was out of the question to expect the two banks at St. Louis and Kansas City to compete successfully with the collection system that could be offered by the larger banks of those places, coupled as it was with the services furnished by correspondents in the eastern sections and with a general network of correspondent relationships throughout

the two districts in question Without going in detail into the history of this southwestern experiment, it may be noted, however, that the work done by the two banks was well worth while, since it demonstrated the entire feasibility of par collection as well as of prompt debit and credit, and thus put to flight a good many of the arguments that were being urged by other reserve banks On the whole great credit should be assigned, therefore, to the banks at Kansas City and St. Louis for their courage in first installing this portion of the reserve banking mechanism, and they should be recognized as having materially contributed to the full development of the system at an early date Without this contribution the full development of the plan might have been deferred for a good while

Tentative Plan Established by Governors

By the early spring of 1915 the issue regarding par collections had been so sharply drawn and the fact that it existed was giving rise to so much criticism—not only on the part of those within the system but also of member bankers and others who desired to see the experiment tried—that a committee representing the governors of reserve banks eventually evolved a plan which was tentatively put into operation The Board determined to keep out of the controversy for a time, and to see what would happen This plan was announced in the Federal Reserve Bulletin and took effect on May 1, 1915³ Its general purport was to establish at federal reserve banks lists of member and other banks who were voluntarily willing to assent to a plan of immediate debit and credit Thus, if, say, 150 banks out of a total of 750 signified their willingness to join the voluntary system of collection, all checks and drafts and cash items that were received on any business morning would immediately be charged off and credited, as the case might be, among this total of member banks On the other hand, items

³ See Bulletin, May, 1915, pp. 6-8, reprinted as Appendix C to this chapter

received from members, whether included in the 150 or not, and drawn upon other members who were not included in the voluntary list, would be put through the process of collection. The effect of the system, had it worked well, would have been that of establishing a par collection system for a limited element in the community, while leaving in another group all of those who preferred to postpone or defer the collection of checks. On the face of the thing, however, the system could not work well and it required only about a year of experience to demonstrate this fact to the satisfaction of all. By the spring of 1916 the Board was already working upon a substitute proposal for the unsuccessful scheme introduced by the governors.

Board's Final Proposal

There had been no lessening of the controversy and friction centering around the par collection question, but on the contrary the irritation produced by the new plan had become more intense. The Board therefore did not think it well to install the system in its original form as contemplated by the act, but determined upon a so-called involuntary collection system in which debit and credit would be deferred—that is to say, if Bank A deposited a check or draft drawn on Bank B, another member, such check would be forwarded to B, and after the lapse of a sufficient period of time during which nothing was heard from B, the check would be charged off against the account of B. The time was carefully calculated in each case on the basis of railroad train schedules, so as to allow in every case a sufficient period within which the check could arrive at the counter of Bank B and be theoretically presented there for cash and a return of funds be made. This meant in the eastern districts a delay of only a day or two in nearly all cases, but it of course greatly impaired the general working of the plan. With this tentative proposal there was coupled, however, a full acceptance of par collection. Every check thus received and debited on the deferred plan was

handled without any charge appropriate to its amount. At the outset, the system undertook to make a small per item charge because of the fact that at the time revenues were so scanty, but even this was later abolished.

The new system went into effect on July 15, 1916, and almost immediately showed its superiority to the tentative plan which it had superseded. It now applied to all member banks, and in order so far as possible to draw in outside banks, reserve banks were urged to say to such non-members that they would be welcome to join under proper conditions in the collection system. Thus for the first time intradistrict collection on a national scale became an established fact, and, taken in conjunction with the gold settlement fund, furnished a means of collecting and paying items in and between all parts of the country—a situation which had never before existed under the older system, wherein individual transfers and individual collections had been the order of the day.

Small Banks Still Hostile

The successful working of the collection system did not, however, appease the small banks. They succeeded in effecting an organization whose purpose it was to bring about a recognition by Congress of the right on the part of every bank to charge an exchange rate of not more than 1/10 of 1 per cent. Such a charge was, of course, very modest as compared with the rates which had been made by many of them in the past, but it was rightly felt that the adoption of any such proposal would constitute a very serious breach in principle and that it therefore could not be thought of for a moment. Notwithstanding that the small bankers succeeded in enlisting the support of a good many of their reserve city correspondents, and notwithstanding that between them they were successful in developing a fairly powerful organization at Washington, Congress continued indisposed to yield to them, more especially in view of the fact that Mr. Glass who was still at the head of the Committee on Banking and Currency, as well as of

course the Treasury authorities, showed no favor to the proposal of the exchange charging bankers

Effort at Legislation

Eventually, however, the opposition element among the bankers gained ground sufficiently to secure the enactment by the Senate of a measure which, had it become operative, would have resulted in the establishment of a charge of $1/10$ of 1 per cent flat upon all domestic exchange. True, it was not so phrased as to interfere with the existence of the so-called par points established by the clearing houses, and they would undoubtedly have continued to exist in the future just as in the past. The effect of the bill, however, would undoubtedly have been to eliminate reserve-bank par clearance and to establish a recognized charge of $1/10$ of 1 per cent. In some ways this would have been a great advance over the condition which had existed prior to the adoption of the Federal Reserve Act, inasmuch as it would have forbidden the exorbitant rates of exchange which had come to prevail in a great many parts of the country. It would not, however, have been more than a partial relief from the exchange conditions which had previously prevailed, and it would have tended largely to destroy the federal reserve clearing system itself.

As has already been indicated, the reason for the existence of the federal reserve clearing system was far deeper and more important than any consideration of exchange charges. Par clearance was necessary in order to direct the stream of checks and drafts to the reserve banks and thus to keep the reserve balances there constantly living and changing, thus preventing them from becoming mere dead sums of cash held simply because required by law. It was the more important that this function should be maintained in view of the fact that the Federal Reserve Act contained so weak and ineffectual an open-market section. So, although there was every reason to favor par clearance from the standpoint of general utilization

of the check system, the real reason for its employment was much deeper. All this of course appealed strongly to Mr. Glass and to his colleagues in the House of Representatives, yet they found it difficult to make headway against the influence of the smaller banks of the country which were strongly set upon the adoption of the proposed legislation. The committee of bankers which was supporting this legislation had taken into its service a former officer of one of the reserve banks who had himself been active and influential in the establishment of par clearance, but who had now turned against it. The passage of the act in some form was apparently unavoidable, so far had the measure been allowed to advance through various legislative stages. How to make it innocuous and to prevent it from throwing the entire clearance system into disorder was a serious question, eventually solved by Chairman Glass through the introduction of an amendment which provided that no federal reserve bank should charge or pay exchange. This largely rendered the remainder of the measure useless, since the purpose of it was originally to authorize member banks to charge exchange at 1/10 of 1 per cent, not merely to one another but also to reserve banks. If the latter could not be called upon to pay exchange, the provision of the act was not of much significance one way or the other.

Thus, once more, the effort to destroy the clearance system, and with it a large part of the federal reserve system, by congressional action had come to nothing. Disappointed in getting assistance in their aims from Congress, the bankers now turned to the courts (after an interim due to the pressure of war conditions), and determined to devote themselves to attack upon the alleged unconstitutionality of the statute. With this, in some states, they combined a general propaganda intended to bring about state legislation which would render the working of the clearance system difficult or impossible within those jurisdictions. Of all this more must be said at a later point, the present chapter being intended only to review the funda-

mental problems that had to be met and solved in connection with the establishment of the clearance system and with its application in practice. Notwithstanding all attacks upon it, this plan has remained practically intact up to the present date (1923)

Working of the Clearance System

As distinguished from the unofficial voluntary system which had first been established under the direction of the governors of reserve banks, the Board's plan of compulsory clearance on the deferred debit and credit basis was immensely successful. While the subject is one which involves a great amount of technicality, and if thoroughly considered would in itself call for detailed discussion, the main facts in its growth may be briefly sketched. The table opposite shows, in general, the statistical development of the system during its early years.⁴

It needs only a review of these figures to recognize how extensively the development of this method of clearing had proceeded. Contrasted with the total clearances of the clearing houses of the country, which in 1922 amounted to \$375,684,000,000, the operations of the system assume great importance, being fully \$120,000,000,000. But, as already stated, the clearing aspects of this clearance system must be regarded as of relatively secondary significance. As a result of the operation of the clearance system, which fortunately came into effect a few months before our entry into the war, the successful working of the gold settlement fund plan was rendered possible. The gold settlement fund could never have functioned with great success had there not been underlying it a tolerably effective intradistrict clearing system, since without this much larger payments would have had to be effected in specie. The larger the basis of items cleared through reserve banks, the more effective and perfect the clearance, and hence the more successful the gold settlement fund in settling bal-

⁴ See Report of Federal Reserve Board, 1917, p. 224

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Month	Average daily number of items handled				Average daily amount of items handled				Total number of member banks	Total number of non-member banks on par list
	Drawn on—		Total	Drawn on—		Total				
	Banks in Federal Reserve city	Banks in district outside Federal Reserve city		Banks in Federal Reserve city	Banks in district outside Federal Reserve city					
1917										
Apr 15	31 162	168,607	12,582	212,351	\$60,288,002	\$32,666,959	\$2,643,498	\$95,598,369	7,625	8,607
May 15	33,797	171,093	15,925	220,785	87,370,850	36,473,183	3,597,865	127,441,887	8,926	8,926
June 15	37,868	179,103	16,344	223,435	97,322,883	38,599,443	4,114,598	140,336,852	7,634	8,780
July 15	38,476	182,622	19,100	240,198	109,722,256	41,004,720	11,637,890	162,364,875	7,661	8,805
Aug 15	36,727	175,625	19,533	231,885	98,075,919	40,353,278	10,701,569	148,130,766	7,683	8,837
Sept 15	36,306	182,191	23,492	241,980	100,331,694	41,323,631	11,006,551	152,661,830	7,718	9,934
Oct 15	40,591	212,935	26,797	286,323	128,271,466	47,476,204	13,518,566	188,266,236	7,747	9,052
Nov 15	47,574	230,723	30,426	310,723	166,552,773	64,296,210	17,496,974	248,345,957	7,826	9,210
Dec 15	47,678	242,756	33,866	332,240	171,753,430	84,441,761	27,179,053	283,343,253	7,823	9,321
1918										
Jan 15	48,549	253,458	38,130	340,137	148,033,108	89,065,135	21,116,203	268,214,536	7,909	9,268
Feb 15	46,207	237,312	48,224	353,847,568	153,847,568	80,248,466	21,316,933	255,212,067	7,972	9,310
Mar 15	51,408	259,531	58,901	369,930	153,701,375	113,134,162	25,827,757	282,663,294	8,013	9,425
Apr 15	55,034	271,506	59,228	385,768	159,441,188	98,090,962	31,563,675	286,206,825	8,059	9,450
May 15	49,569	287,061	60,771	397,401	178,372,385	114,099,250	30,228,185	323,400,090	8,113	9,470
June 15	51,955	295,056	67,750	423,861	164,539,000	143,407,619	39,954,403	317,000,622	8,165	9,711
July 15	53,549	391,264	82,536	537,349	192,220,658	143,751,620	47,181,467	335,153,745	8,212	9,766
Aug 15	50,229	406,330	81,323	537,882	172,600,132	131,047,263	45,695,643	344,771,041	8,204	10,205
Sept 15	55,123	441,979	87,213	554,315	182,321,867	145,374,804	45,695,643	373,392,314	8,428	10,549
Oct 15	64,931	495,441	106,539	666,911	208,639,006	169,025,374	51,048,149	428,712,559	8,510	10,318
Nov 15	82,434	550,484	98,168	731,086	231,014,467	191,310,103	52,790,232	475,114,862	8,594	10,219
Dec 15	85,174	590,685	135,173	811,032	219,162,199	167,471,893	60,766,938	447,401,030	8,612	10,400
1919										
Jan 15	98,584	632,118	77,282	797,984	224,904,918	162,371,765	37,753,800	428,530,483	8,702	10,246
Feb 15	99,944	599,951	126,051	816,946	198,935,424	156,360,424	33,221,002	418,517,185	8,724	10,483
Mar 15	109,083	640,346	114,563	863,992	168,567,377	171,714,559	46,746,505	397,028,471	8,735	10,718
Apr 15	138,817	686,512	137,228	962,557	197,456,121	167,142,626	49,320,926	413,028,309	8,758	11,060
May 15	129,378	665,641	157,820	952,839	176,737,129	163,067,746	45,278,441	385,083,316	8,786	11,288

ances between different parts of the country and therefore in avoiding the shipment of specie. As elsewhere seen, it was through the working of the gold settlement fund that enormous payments growing out of subscriptions to Liberty bonds during the war could be successfully transferred from one part of the country to another, without overthrowing the banking and monetary stability of either.

So, in the large sense of the term, the successful working of the clearance system must be regarded as the basis of the successful financing of our share in the war. More important than this is the fact that the unification of exchange and the direction of a large and steady flow of items through the reserve banks has formed the essential basis of success on the part of reserve banks in their other operations. As the federal reserve system has expanded and as its branches have become more numerous, the possibility of securing the abandonment of clearing houses has become greater, and an increasing number of such clearing houses have either transferred their functions to reserve banks or have greatly limited them in favor of the latter. It is probably not too much to say that without the clearing system in effective operation, the federal reserve system would have been greatly handicapped and could not have succeeded in the fullest sense of the term.

Banking and Business Interests

And yet there has never been a time during the history of the federal reserve system when the welfare of the clearance system could be considered sure. The business interests which profited so greatly from past clearance have only slowly come to appreciate the help they received from this source, and while at the present time the majority of larger business establishments are undoubtedly in favor of it there are many of them which hesitate to take any positive point of view, knowing as they do that their bankers are not friends of the system. In Congress, notwithstanding the constant outcry against the

so-called money trust or banking interests, the small bankers have always been very powerful and may at any time secure affirmative action by Congress abolishing par clearance, should the vigilance of those who believe in it be at all relaxed. Lacking branch banks, it is safe to say that our banking system cannot successfully function at all without the aid of methods which will supply the same means of unification and harmonization in currency movements that are obtained under the branch banking program.

The fact that all this has not been clearly understood and accepted, and is today questioned by many, constitutes one of the most regrettable commentaries upon the banking situation in the United States. How long the condition thus represented will continue is a question whose interest is, of course, very great from the standpoint of the future of the federal reserve system, but which of recent years has tended to be pushed into the background because of the emergence of other and more pressing questions involving the very existence of the system itself. It was a remarkable tribute to the wisdom of that section of the Federal Reserve Act which provided for par clearance that it eventually succeeded in triumphing even over the doubts and fears expressed by the members of the Federal Reserve Board itself and of other officers of the system who in the beginning had been doubtful or hostile to its application.

This change of front, although creditable to those who have accepted it, is by many of them explained on the ground that the system of clearance originally proposed was based upon the idea of *immediate* debit and credit, whereas that which has been accepted is based upon *deferred* debit and credit. As to this it should be noted that the provision of the original act said nothing as to the time at which debit and credit should take place, although by using the terms "clearance" and "clearing house" it had evidently contemplated immediate charge-offs. The truth is that the failure to make the debit and credit immediate has been a considerable barrier to success. There is the

same reason for making an immediate credit in favor of a check drawn upon a bank, say, in Cincinnati or Chicago, as there is in giving to a depositor immediate credit for the notes of the same bank. The philosophy of the matter is apparently simple, although it has gradually become overlaid and obscured with technical discussion. Eventually it will vindicate itself as completely as the system of clearance itself has been vindicated, and the conclusion will be reached that it is a part of the public service of the banks to make their funds immediately available in all parts of the country through a satisfactory system of clearance which will permit conversion to cash without delay or cost.

APPENDIX A TO CHAPTER XLVI

Following are notes on the discussion which took place at the conference of reserve bank governors with the Federal Reserve Board, held in November, 1914, on the subject of putting into effect the provisions of the Reserve Act relative to collections. The various governors are designated by letters of the alphabet.

CONFERENCE ON CHECK COLLECTIONS IN NOVEMBER, 1914

GOVERNOR A. Governor Hamlin, we have felt that the fundamental thing to be decided before we could arrive at a satisfactory basis of settlement, was, as Mr. _____ suggests, the matter of what was meant by the word "par,"—whether or not par means without an exchange charge and for immediate credit on receipt. I am one of the conservatives of this body. It seems to me that the element of time is one that can't be overlooked. We can't devise any scheme that will eliminate it, which is one of the fundamental factors. The acceptance of a check on the Federal Reserve Bank of San Francisco by the Federal Reserve Bank of Boston involves a transit term for which the depositing bank, in my judgment, should not be given allowance in crediting a balance against which he can draw, because the minute you give him immediate credit at par, you allow him to draw against that when his check to _____ in New York is in clearing house funds the next morning against an item which is five days in transit, for his real money. This practice to my mind is a very dangerous one and I have felt pretty strongly that it would be a very hazardous thing for us to

permanently be sponsors for an opinion that asserted that time was not a factor, that a San Francisco check was as good as cash in New York or Boston. While I do not think the great State Banks that are run on sound banking lines would avail themselves of it, it opens a field to some of the banks in the more remote districts to keep floating a large amount of checks against one another.

One of the very fundamentals that this Board has to deal with, is to settle on an economic basis. The method of settlement is fundamental in the matter of handling balances between the banks.

GOVERNOR HAMLIN. How would you define par?

GOVERNOR A. That is what we came to find out!

I should say that par was as cash, the equivalent of cash, but my idea is that par in the Federal Reserve Act cannot mean that. If a man said to me a check is good at par, I assume that he means to get through clearing house fund for next morning cash in settlement.

GOVERNOR C. I believe that greater progress will be made in the solution of this problem by confining this discussion really to a definition or better understanding of what should be the definition of the statute in stating that certain checks shall be received on deposit at par. My understanding of par—not as a dictionary may define it, but as it is accepted in banking practice, means making a check available at once for a draft against its proceeds without a charge for collection, without any deferred time for its collection, or without a discount or premium on account of the discount or premium of exchange of the state on which it is drawn, i.e., the check should be convertible into cash at once after it is placed in the account of the holder with the bank. If that practice of making checks par in that sense is generally adopted, I fear that it will lead to unsound banking practice, and our problem is to find the means of handling these overchecks on Federal Reserve Banks which will restrain member banks from making use of funds which, in fact, do not exist when they deposit those checks with the Federal Reserve Bank of their own districts. Personally, I believe with Governor _____, that the greatest precaution that can be afforded against the development of unsound banking practice, will be to introduce time and other incidents, i.e., the holder of the check will not be able to get the proceeds of that check at command for a draft until the bank which handles the item has had at least sufficient time to get it to the place of payment, no matter how distant or how near that place may be. In adopting that principle, if we decide to do so in handling checks drawn on Federal Reserve Banks, we establish a very important principle in extending the system of handling checks

to checks drawn by member banks on other member banks and to checks drawn by customers of member banks on other banks. This, possibly, is the proper time for me to make a little explanation in regard to the attitude taken by the Federal Reserve Bank of New York on this matter. We read the statute, together with the recommendation of the meeting held on October 22nd in Washington together to mean that the Federal Reserve Banks were in fact expected to receive these checks drawn on other Federal Reserve Banks on deposit for immediate credit at par. That decision on our part was not arrived at as the result simply of the reading of the statute or of the proceedings at this conference, but after submitting the question first to a committee of men who had had great experience in transit matters in New York, who reported that those checks should be handled in that way. We also submitted the question to a committee appointed by the New York Clearing House Association that has had the whole subject of clearance under consideration for ten or twelve years past, and they made some recommendation and following the recommendation of those two committees and the conference at Washington, we undertook to receive the checks on deposit for immediate credit at par, and so notified our member banks, and the result, I fear, has been to create a situation in the mind of some of the Governors of the other Federal Reserve Banks, that with the exchanges in the position they are now some will be entirely "pumped" out of their reserve by the remittance of checks drawn on other banks than New York, for the purpose of making New York exchange. If that question has arisen, it is a great misfortune, because that was never in the minds of anyone connected with the New York Bank, and, furthermore, we would be willing to meet the calls which might be made on us to ship currency to any extent that was necessary in order to test this plan, and to bear a considerable share of shipping it in order to test the plan if it were felt to be the fair thing for us to bear that expense, and my position is to urge that a sufficient period of time be allowed to question the experiment as to what is to result from the practice of an effort to make these checks par, and if it is found to be unsound so far as we are concerned in our district, we have so carefully qualified our circular and our application to the New York Clearing House Association that there will be no hesitancy on our part in changing that course at once if it is found to be unsound or burdensome on any bank.

GOVERNOR HAMLIN Is the word "par" in banking practice inconsistent with collection charge?

GOVERNOR C The answer to that question I think is that there are

two possible constructions of the word par One has relation entirely to the question of a premium or discount on exchange between any two sections of the country, the other, or more inclusive interpretation of the word, would cover both a possible premium or discount on the check and possible loss of interest by reason of deferred credit and possible charge of collection fee to cover the expense of collecting the check

GOVERNOR E We may be making an economic mistake in attempting to handle checks without recognizing the element of time and we might lose sight of the object of the Federal Reserve Act, which was to furnish legal reserves, by locking up too much of our resources in the collection of checks

GOVERNOR G Governor Hamlin, I think this matter of par is of very vital importance in establishing relations of the banks As Governor . has expressed it the term of par in banking practices, is a matter of crediting a check on receipt If that practice were followed out here, it would seem to me that we would have created a fictitious element of reserves of the banks items in transit from San Francisco, five or six days away It seems to me that this matter of time must be taken into consideration in some way It is quite vital to know just how that is to be treated What the word par means too, we can work out, also a general system of settlement that will be satisfactory to all banks

GOVERNOR H We have considered today more particularly the relations between the Federal Reserve Banks, but we feel that the action taken by the banks between themselves will either lay down a principle or will be construed to lay down a principle which would be expected to govern the member banks in dealing with their own customers, etc I feel, Sir, that the only principle that can justify the receipt by one Federal Reserve Bank at par of a check on another distant Federal Reserve Bank, is possibly by regarding them all as branches of the same head I do particularly feel that if we take checks on one reserve bank at par, be it San Francisco, Chicago or Cleveland, that our member banks in all probability will expect us to take at par the checks which they put with us on different points I believe that we may estimate to be afloat in the mails somewhere in the neighborhood of two hundred millions of dollars If we were to adopt that practice the entire present resources of the banks might be absorbed, in the mail

We feel that the determination of the definition of the word "par" is a very important matter now Whether or not there is to be a

difference in the meaning of the word when Federal Reserve Banks are dealing with each other and when they are dealing exclusively with their member banks, is an important question to be settled. We might be ready to accept the definition of the word *par* to mean immediate credit without charge in all dealings between each other. I feel that it would be adopting a dangerous principle in receiving from member banks promiscuous checks from different points they might deposit with us for immediate credit and subject to be drawn against at once.

GOVERNOR J. Par is for an exchange purpose. It would be unwise banking to admit checks to be received at *par* placed subject to immediate checking account. As the gentlemen who have preceded me said, it would exhaust the reserves, throw them in the mail and would open a door to an inflation that I do not think was intended by the law. The question of charges can be determined by your Board as to what is reasonable for the collection of these items not as a matter of exchange but as a matter of expense.

GOVERNOR L. In banking practice, it has always been my understanding that the term "*par*" when applied to a bank draft, meant that the bearer of that draft or the holder of it was entitled to cash on presentation. I have hoped that the Federal Reserve Board might find some other definition in applying the term, in so far as the Act is concerned, for the reason that has been stated by several of the gentlemen that it seems hardly fair for the depositor to accept or to expect or take credit for a San Francisco or Dallas item in New York on the day it is presented, when that item will be out for from three to five or six or ten days before returns are available. That is about all I have to say on the subject. I hope that banks in dealing between Federal Reserve Banks will be permitted to make allowance for the time consumed in collecting the items.

GOVERNOR P. Every State Bank has what they call a *par* list, checks upon which they will accept a credit upon receipt. No charge is made against items appearing upon the *par* list. There is a feeling prevalent in our part of the country that this exchange on Minneapolis and on Dallas, Atlanta, Chicago and New York all have been put upon a level. This is the impression which prevails—the impression or feeling we have got to meet. In view of that it seems to me that the method which has been started by the New York bank is a good one and we shall endeavor to give it a fair trial and see if the pendulum will not swing as far in one direction as the other. There might be times when it might prove burdensome to one bank, and if it did,

adjustment could be called for, but it does seem to me that, in view of the fact that the public have the opinion that par means that checks are going to be par, they ought to give it a fair trial

GOVERNOR R Governor Hamlin, Governor has expressed the sentiment that exists among member banks generally They feel that these checks are going to be parred, i e, they are going to get credit for them upon receipt In our district our committee has concluded to put in a clearing system between member banks of our district I have a telegram today that they had sent out circulars advising banks that they had done thus We propose to try to get the flood of items to the bank in sufficient time to cover the charging of outgoing items to member banks' account I do not know how this experiment will work out, but Governor received a telegram this afternoon from the Vice-Governor saying that it was working very nicely down there It is hard to tell what the result will be My own judgment is that we will have to put a time limit on those credits In our particular district we probably have to have two or three days deferred credits

GOVERNOR T Mr Governor, we are rather seeking to place a definition upon the term par that will fit a practical operation of law on the definition at which we may arrive Even though we should determine here tonight just what the term par contemplates under the Act, we would still be contending with the problem of putting in operation in the face of existing conditions and existing practices I think we all agree that the Act in handling items or in providing for the handling of items for the Banks, intends to handle them in some such way as will give to trade and commerce a more efficient service than under the old way Therefore, we are confronted with the necessity of meeting upon some ground which will offer sufficient inducement to the member banks to employ the service upon which we may determine and not to create an imposition upon the banks in employing them That is necessary in order to reach the degree of efficiency defined by Mr under the term of service If we should adopt the interpretation of the law given by Mr Warburg it will be plausible and defensible We would then be confronted with the necessity of what is actual cost and the manner in which we can arrive at it, also the necessity of determining that actual cost upon some basis which will overcome too great an investment on the part of the Federal Reserve Bank of its own gold certificates and yet meet existing conditions by which the average member bank sends his items to his present cor-

respondent, counting them as reserve from the moment it is entered upon his books. If we can evolve some sort of a plan from the standpoint of the member bank that is workable, the system will not be employed and the purpose for which it was intended will be defeated. If we were able to eliminate the necessity of the transition period of three years of putting the transfers from the vaults of the banks into the Federal Reserve Bank, then we could look into the matter in a different manner. But if we undertake to accept those items for credit after sufficient time has elapsed to be converted into something available, we are asking for more time for them than is now allotted.

After all, we are confronted with a practical problem should we arrive at the definition of par. The question of par in the Act is primarily concerned with the manner of handling items from member banks. We bring it to you at this time under the head of the relationship that shall exist among the twelve banks, because we believe that it is a vital matter to be settled that we may establish a precedent for the purpose of establishing the definition when we come to the question of the clearance on the part of the banks. I am very frank to say that so far as my district is concerned, we are subject to foreign fluctuations in the matter of movement of currency in exchange. We do not have that opportunity of "washing out" which is the term frequently used around the Board room. It is either going one way or the other in vast sums relatively. At this time of the year normal eastern exchange would be at a discount with us. That season has been deferred for the lack of the movement of the commodity which we produce. For the last several months the banks have been shipping whatever form of currency they can get hold of to sustain balances against which they can draw in the settlement between each other out of the clearance of checks. They have been reduced to the necessity of shipping gold and gold certificates in such sums as conditions warrant then holding. Under the practice which we seem to be under necessity of imposing there is no question but what we would be a shipping bank to the eastern banks. If the movement of cotton should open up readily we can obtain sufficient New York exchange to carry on the liquidation at eastern points, but, unless it does open up, we will be under the necessity of shipping the currency which we have down there representing a reserve against deposits carried to eastern points to take care of whatever liquidation we may be able to carry on. If, after the commodity has moved, we will be on the other side, and the reserve cities whose place we take in a large measure have been under the necessity in the summer time and early fall of shipping

large quantities of currency to meet the needs of our district. When the need for it has passed away we ship it back. If our drafts drawn on the Federal Reserve Bank of _____ are to be accepted currently over the country, the Federal Reserve Bank will take its place in that shipping portion because of the device of settling weekly or monthly the one we may agree upon, because we will get rid of some duplication, but we will be a shipping bank at certain seasons of the year.

Mr. Governor, I think that covers the situation at _____. I think Mr. Warburg's definition on interpretation of that paragraph of the law dealing with the term *par* is very plausible and very defensible, but it still does not assist us in the problem of how to apply the law to the practical operation of the twelve Federal Reserve Banks.

MR. U (CASHIER) We have discussed the thing more or less and have agreed that we would try out whatever is offered, subject to analysis, and later on make reports. I think he (Governor) agrees with me on my view of it. He did make a statement to me one time that the handling of this clearing business was a side issue which did not belong under the Act. We have gone into the Comptroller's reports and the figures due from banks other than reserve agents is forty million dollars approximately. The report shows forty million dollars due from other reserve agents.

GOVERNOR C This is the first meeting of the Governors of the Federal Reserve Banks, when they have met together alone, to discuss these problems, and I may say, quite frankly, that when I came to Washington most of them were strangers to me, and while we have been debating these matters we have all been forming our own conclusions as to the personnel and management of the banks. I can assure this Board with the utmost confidence and conviction, that this and the other problems that we have got to solve, are in safe hands. During the two days and two nights that we have devoted to this matter one thing that has stood out as a distinct characteristic of the discussion, is the desire of each one of these gentlemen to give the matter fair, earnest consideration in order to develop the sound practice for the banks, and whether you decide to make regulations or not, I am going home with an entire confidence that this matter is in perfectly safe hands. There may be a lot of mistakes made, but they will be corrected and whether you tell us what *par* means or not, or whether we take six weeks for experiments, or six months, we are going to find out what *par* means and what the safe solution of the problem is, and really, for the first time, I am beginning to feel a sense of comfort for this whole situation. We all mean business and

are going to help you and each other to work it out in a conservative way. The deliberations of these last two days have been of the greatest value. The discussion has established the fact that not only do the Governors of the Federal Reserve Banks want to avoid mistakes, but they want to avoid the more serious thing of starting something that can't be stopped until it reaches a very unsound situation. I do not want to have this meeting with the members of the Board adjourned without giving that assurance, and I hope every one of the Governors cherish that feeling which I have most strongly.

GOVERNOR HAMLIN. I think we can say it has been of the greatest value to us to hear you gentlemen. You have thrown much light on certain points in my mind. I think at this time it would be very desirable for the Governor of each district to say exactly what they are doing today. Let us begin with Number — and go backwards.

MR. U (CASHIER). The Federal Reserve Bank of _____¹⁵ accepting all deposits at par for immediate credit and immediate deposit in their bank, all drafts of member banks on member banks in Federal Reserve Cities at District No. _____ and all drafts of member banks on Federal Reserve Bank of _____. I do not think we have been offered any check on any other Federal Reserve Bank. We have received four deposits from Atlanta, a very small check on ourselves drawn by one of our member banks and credited to Philadelphia.

GOVERNOR T. We are accepting checks drawn on Federal Reserve Bank of Dallas and drawn on member banks in the six reserve cities of our district from member banks. Items drawn by member banks on the member banks in those six cities. In that operation we have invested some three or four hundred thousand dollars. We have given credit to the Federal Reserve Bank of New York of the checks which they have sent us on a form provided for collection.

GOVERNOR R. We are accepting drafts drawn by member banks on member banks in the district and upon the Federal Reserve Bank. We are receiving one or two items from Federal Reserve Banks in other districts.

GOVERNOR P. Minneapolis is taking drafts drawn by member banks in reserve cities. Also drafts drawn by any Federal Reserve bank. Our district is fortunate, possibly, and the Dallas district is unfortunately situated with respect to the number of reserve cities. We have only two, St. Paul and Minneapolis. We have not met with those difficulties that some of the members have come across. I fully appreciate that it makes a difficult problem for them and am glad we do not experience it.

GOVERNOR L We are receiving at . checks drawn on the member banks within the reserve cities in our district, including , and seven reserve cities in addition to Our items are now running at about thirty-five hundred dollars per day

GOVERNOR J We are taking checks of member banks on member banks in reserve cities, four in number In accepting these checks we charge them and give credit on the date of receipt and charge to the bank in the reserve cities on whom drawn, and in two instances it has developed their reserves and left small overdrafts They reimburse by giving us exchange on New York, largely caused by the movement of cotton Have telegraphed Governor and got his consent to accept for credit for our account items drawn on member banks in the City of New York and we are receiving checks on the Federal Reserve Banks and receiving in reimbursement checks drawn on member banks where there are Federal Reserve Banks when I can get that arrangement made We will probably not have any to accept on New York, and probably on Philadelphia and Richmond Nashville, in reimbursing, sends us items drawn by Louisville on member banks in St Louis, I believe, and we have created a balance in St Louis because of that That is the extent of our handling of items up to the present time

GOVERNOR H Up to a few days ago we confined our operations to the agreement reached at the conference with your Honorable Body and received from member banks their checks on member banks in the reserve cities of our district only Within the last few days, due to the fact that some reserve banks were receiving for credit items on other reserve banks there have been sent to us from other reserve banks items on ourselves We have received those drafts for credit and we are debtor to those banks to the extent of some three hundred thousand dollars Would state that in our relations with our member banks in receiving items only upon the reserve cities, that we found perhaps one or two illustrations of what I mentioned earlier One bank that I have in mind would use us to draw unavailable balances from a very close neighboring city to send us, and at the same time would draw upon us for the same amount, his check reaching us at identically the same time as his remittance of those drafts on his neighboring city That is the situation with us

GOVERNOR G We are receiving from our member banks for credit their drafts on the reserve cities in the district, four in number, including Cincinnati, Columbus and Cleveland, also receiving their drafts on Federal Reserve Banks for excess balances

GOVERNOR E We are receiving checks drawn by member banks on member banks in reserve cities in our district. But there is only one Federal Reserve City and as we are associated with the Clearing House we get immediate payment for those checks. We are also receiving checks drawn on any other Federal Reserve Bank, with the result that we are more or less creditor of some other reserve banks.

GOVERNOR C There are only two reserve cities in our district outside of the , one of them being , and the other

We followed the recommendation of the meeting in October held in Washington and advise the banks in our district that we would receive checks drawn by member banks of the district on another bank in any reserve city. The question of receiving on deposit at par for immediate credit checks drawn on other Federal Reserve Banks was in a measure forced upon us by the operation of exchanges.

GOVERNOR A We have but one reserve city in our district, . We accept checks drawn by member banks on member banks in that city, and checks on all Federal reserve banks, and give them credit at par.

APPENDIX B TO CHAPTER XLVI

Following is letter of counsel to Federal Reserve Board, dated January 4, 1915, giving his opinion on the subject of check clearings.

CLEARANCE OPINION OF COUNSEL TO BOARD

My dear Governor —

By direction of the Board, the Secretary has referred to this office for an opinion that portion of the report of the Advisory Council submitted by Mr. J. B. Forgan, President, which deals with the subject of check clearings. The part of the report referred to reads as follows:

"Check Clearings

"The Federal Advisory Council is unable at present to make definite suggestions on this subject.

"As a preliminary the Federal Reserve Board or its counsel should determine whether under Sections 13 and 16 of the Federal Reserve Act, Federal reserve banks are either permitted or required to receive on deposit from their *depositors* checks drawn upon member banks or Federal reserve banks of other districts. As the Council reads these sections such checks can only be received on deposit by a Federal reserve bank 'when remitted by' another Federal reserve bank and then solely for exchange purposes. In the opinion of the Council it is unsound in principle and wrong in practice that a check drawn on a member bank should be charged to its reserve account with a Federal reserve bank without its authority and without its having had an opportunity to pass upon it. The Council fears that the attempt being made by some

of the Federal reserve banks to disregard the elements of time and distance in connection with the clearing of bank checks may so involve and absorb the funds of the Federal reserve banks as to seriously impair their usefulness as banks of issue and discount"

It will be observed that two questions are presented for consideration—

The Act says

First Can a Federal reserve bank, under the terms of the Act, be permitted or required to accept on deposit checks and drafts drawn against banks which are members of other Federal reserve banks?

Second Can a Federal reserve bank, receiving on deposit or by remittance from another Federal reserve bank checks or drafts drawn against one of its member banks, charge up such checks or drafts against the reserve or deposit account of a member bank without instructions or authority from such member bank?

While these two questions may be said to be related, or at least that both are to be considered as part of the general subject of clearances, the legal questions involved are distinct and they should be considered separately

The first question involves an interpretation of the language of Sections 13 and 16, to which Mr Forgan calls attention, and which relates to specific powers of Federal reserve banks, and also an interpretation of Section 4, Sub-section 7th, of the Federal Reserve Act which deals with the general corporate powers of Federal reserve banks That part of Section 13 which relates to this subject reads as follows

"Any Federal reserve bank may receive from any of its member banks, and from the United States, deposits of current funds in lawful money, national bank notes, Federal reserve notes, or checks and drafts upon solvent member banks, payable upon presentation, or, solely for exchange purposes, may receive from other Federal reserve banks deposits of current funds in lawful money, national bank notes, or checks and drafts upon solvent member or other Federal reserve banks, payable upon presentation"

That part of Section 16 which relates to this subject matter reads as follows

"Every Federal reserve bank shall receive on deposit at par from member banks or from Federal reserve banks checks and drafts drawn upon any of its depositors, and when remitted by a Federal reserve bank, checks and drafts drawn by any depositor in any other Federal reserve bank or member bank upon funds to the credit of said depositor in said reserve bank or member bank Nothing herein contained shall be construed as prohibiting a member bank from charging its actual expense incurred in collecting and remitting funds, or for exchange sold to its patrons The Fed-

eral Reserve Board shall, by rule, fix the charges to be collected by the member banks from its patrons whose checks are cleared through the Federal reserve bank and the charge which may be imposed for the service of clearing or collection rendered by the Federal reserve bank

"The Federal Reserve Board shall make and promulgate from time to time regulations governing the transfer of funds and charges therefor among Federal reserve banks and their branches, and may at its discretion exercise the functions of a clearing house for such Federal reserve banks, or may designate a Federal reserve bank to exercise such functions, and may also require each such bank to exercise the functions of a clearing house for its member banks"

Section 4, Sub-section 7th, in dealing with the general corporate powers of banks reads as follows

"To exercise by its board of directors, or duly authorized officers or agents, all powers specifically granted by the provisions of this Act and such incidental powers as shall be necessary to carry on the business of banking within the limitations prescribed by this Act"

In passing upon the questions under consideration it is necessary to consider together the foregoing provisions of the Federal Reserve Act in determining (a) whether the power to receive such items on deposit is a power specifically granted by the Act, or (b) if not specifically granted, is the exercise of this power necessarily incident to any power which is specifically granted

It needs no citation of authority to sustain the proposition that although not specifically granted, a power may be exercised which is necessarily incident to a power which is granted. This is not only the well recognized American rule relating to corporate powers, but such rule is specifically recognized by Section 4, Sub-section 7th, above quoted

Considering the question from the first standpoint, Section 13 provides that *"any Federal reserve bank may receive from any of its member banks deposits of checks and drafts upon solvent member banks or, solely for exchange purposes, may receive from other Federal reserve banks deposits of checks and drafts upon solvent member or other Federal reserve banks"*

Section 16 provides that *"Every Federal reserve bank shall receive on deposit when remitted by a Federal reserve bank, checks and drafts drawn by any depositor in any other Federal reserve bank or member bank upon funds to the credit of said depositor in said reserve bank or member bank"*

It will be observed from the foregoing that under Section 13 Federal reserve banks may receive from their own members checks and

drafts upon solvent member banks. It is necessary, therefore, to determine the meaning of the language *checks and drafts upon solvent member banks*. Does this mean banks which are members of the same Federal reserve bank as the depositing bank, or may a bank deposit in the Federal reserve bank of which it is a member checks or drafts drawn against banks which are solvent member banks of other Federal reserve banks?

The term "member bank" is defined by Section 1 as "*any national bank, State bank, or bank or trust company which has become a member of one of the reserve banks created by this Act*"

Attention is called to the fact that the bank which is authorized to make the deposit in a Federal reserve bank is designated as "*any of its member banks*" while in designating the bank against which items may be drawn this possessive pronoun is omitted and the language used is "*checks and drafts upon solvent member banks*". The omission of this qualification is doubly significant in the next clause where the statute provides that "*solely for exchange purposes may receive from other Federal reserve banks checks and drafts upon solvent member or other Federal reserve banks*".

In this latter case the statute not only fails to qualify which member bank such checks and drafts must be drawn against to be received but the context clearly shows that Federal reserve banks are expected to receive checks and drafts on banks which are members of other Federal reserve banks. For example, let us assume that the checks sent to the Federal reserve bank solely for exchange purposes by another Federal reserve bank are checks and drafts drawn against the receiving bank. It necessarily follows that the forwarding Federal reserve bank must have previously received such items from some source, that is to say, from one of its member banks, from the United States Government or from some other Federal reserve bank.

It would seem clear, therefore, that the language "*checks and drafts upon solvent member banks*" must be construed to mean checks and drafts drawn against banks which are members of any Federal reserve bank.

The same conclusion seems inevitable in Section 16 since a Federal reserve bank could not remit items drawn against depositors of other Federal reserve banks without first receiving such items from some source. If there should be any doubt as to this interpretation of the language "*solvent member banks*" and the conclusion should be reached that the power to receive checks and drafts on banks which are members of other Federal reserve banks is not specifically granted by

statute, such a power must nevertheless be construed as a power incidental to those powers which are specifically granted for the reasons above stated

The second question raised in the report referred to relates, as stated, to the right of a Federal Reserve bank to charge items sent it for collection against the account of a member bank without authority from such member bank. Mr. Forgan states that

"In the opinion of the Council it is unsound in principle and wrong in practice that a check drawn on a member bank should be charged to its reserve account with a Federal reserve bank without its authority and without its having had an opportunity to pass upon it."

I am not entirely clear upon just what theory a Federal reserve bank undertakes to charge up items drawn against other banks without authority from such bank. When a member bank makes a deposit in a Federal reserve bank to its reserve account, or to any other account, the relation of debtor and creditor is immediately established as between the Federal reserve bank and such member bank, and the credit balance thus created can legally be drawn against only by the depositing bank.

When any bank receives on deposit checks or drafts drawn against other banks, such items are accepted for collection as agent for the depositor and this agency continues until the items are actually collected.

It is true that in many instances the bank receiving such items on deposit immediately credits these items to the account of the depositor but where this is done it is credit extended upon the responsibility of the depositor and the bank reserves the right to charge back such items to the depositor's account if they are returned unpaid. Where the items are forwarded to correspondent banks for collection such banks in turn accept them as agents and the relation of debtor and creditor is not finally established until the check or draft is actually paid by the bank against which it is drawn. The decisions of our courts are uniform on this subject. Accordingly, where a Federal reserve bank in due course of business receives checks or drafts from any source for deposit or collection it acts merely as the agent for the depositor until such items are collected, and as such agent it has no right to appropriate funds held by it belonging to the bank against which such items are drawn for the payment of such items without specific authority from the bank in question. The depositing bank and not the bank against which such items are drawn is liable to the Federal reserve bank for any credit given to such depositing bank on the strength of such items, and the question of whether or not the deposit-

ing bank should be given credit immediately, or after the items are collected, is one for consideration by the Board

Respectfully,

Hon Charles G Hamlin,
Governor

(Signed) M C ELLIOTT,
Counsel

APPENDIX C TO CHAPTER XLVI

The following announcement regarding the putting of the check clearance plan into operation was published in the May, 1915, number of the Federal Reserve Bulletin

PLAN FOR CLEARING CHECKS

The Federal Reserve Board announced on March 4, 1915, that it had determined to direct the introduction of a voluntary reciprocal plan for immediate clearance at all Federal reserve banks where a clearing plan was not already in operation. This clearing plan is to be put into effect with as little delay as possible. Letters were sent to Federal reserve agents directing that they take up this matter with their boards of directors at once.

The Board did not attempt to prescribe details, since it had been found that in districts where general clearing was in practice the best results were obtained by leaving the control with the bank officers. In general, the plan contemplates, however, as a beginning, a reciprocal arrangement by which banks assenting to the plan will be given the privilege of immediate clearance at par on all other banks similarly assenting.

Circulars have been issued by Federal reserve banks to their member banks outlining the clearing system. These are similar, and that issued by the Federal Reserve Bank of Chicago is given below as an illustration of the manner in which the work has been undertaken. Special conditions in the twelfth district (San Francisco) may necessitate some modifications intended to adapt the plan to the local situation. It is desired to put the plan into operation generally about May 15, 1915.

Federal Reserve Bank of Chicago,
79 West Monroe Street,
Chicago, April 7, 1915

To the member banks of district No 7

The Federal Reserve Bank of Chicago, in accordance with the

terms of the Federal reserve act and the rulings of the Federal Reserve Board, is prepared to inaugurate, for the benefit of its members, a system of intradistrict collection, that is, a system of collection of checks and drafts received from and drawn on member banks in district No 7 Membership in the system will be voluntary and items will be received only from and upon those banks which join it Such items will be immediately credited and debited to the accounts of the sending and paying banks, respectively, subject to final payment

For the present the system will not embrace the interdistrict collection of checks and drafts, that is, the collection of checks and drafts drawn on banks outside of district No 7 Such broader service can only be developed for the member banks of the various districts after experience shall have been gained in operating the intradistrict service now offered

This system is not intended to supersede the exchange of checks through local clearing houses or otherwise in or between near-by cities or towns And wherever, in the case of a section far distant from its reserve bank or overlapping two reserve districts, or for any other reason, the collection of checks is being made more quickly or economically by direct interchange between the banks of the section than would be possible under the proposed plan, such relations, for the present at least, will doubtless continue

The collection system outlined herein is offered by the Federal Reserve Bank of Chicago as the first step in the improvement of present methods of collecting checks within its district. It is the result of much consideration on the part of the directors and officers of this bank and of many conferences of the governors of the various Federal reserve banks This plan has been authorized by the Federal Reserve Board, and it is understood that substantially similar systems of intradistrict collection will be introduced by all other Federal reserve banks The system will be subject to such modifications or extensions as experience may show from time to time to be necessary or advisable

The directors of each member bank which joins the collection system will be required to adopt and file with the Federal Reserve Bank of Chicago resolutions agreeing to the rules and requirements of the system The resolutions and the rules and requirements are attached hereto There is also inclosed a copy of the resolutions, with the rules and requirements attached, to be executed and returned to this bank when the resolutions have been adopted by your board of

directors Action thereon by your board is requested before May 15, 1915

A further circular will be issued containing a list of banks which have joined the collection system, announcing the date upon which it will begin operations, and giving such further information as may be necessary

The collection system herein proposed is based upon the experience of other countries where similar systems have been in operation for many years and have been developed to a high point of efficiency

It is believed that the establishment of the collection system in the 12 Federal reserve banks will provide a safe and economical method for the collection of country checks and will go far toward correcting the recognized evils resulting from the indirect routing of such items

We earnestly solicit your careful consideration of the plan, also your cooperation in its development, believing that it will result in substantial benefits to all concerned With the system established, we will do all in our power to render our member banks the most efficient service in its operation

Very respectfully,

JAMES B McDUGAL,
Governor

Bulletin No 29.

RULES AND REQUIREMENTS GOVERNING THE OPERATION OF THE
COLLECTION SYSTEM OF FEDERAL RESERVE
BANK OF CHICAGO

1 Each member bank joining the system authorizes the Federal Reserve Bank of Chicago to charge immediately on receipt against its account, subject to payment by such member bank at its banking house, checks and drafts payable upon presentation drawn upon it, deposited by other member banks which have joined the collection system

2 The member bank undertakes to provide sufficient funds to offset the items charged against its account under the collection system, without impairing the reserve required to be kept in the Federal Reserve Bank of Chicago, as shown by the books of the reserve bank, the amount of such funds to be determined by experience gained from actual operation

3 Checks and drafts payable on presentation drawn on any member bank in district No 7, which has joined the collection system, will be received for immediate credit, subject to final payment, but only from

such member banks as have joined the collection system. Items marked "Payable if desired" at either a member bank or a nonmember bank, will not be received unless drawn on a member bank which has joined the collection system, in which case they will be charged to the member bank upon which they are drawn and not to the bank at which they are made "Payable if desired."

4. Items sent for credit should be divided in two classes:

(a) Items on member banks which are members of the Chicago Clearing House Association

(b) Items on other member banks in this district

The items under each of these divisions should be listed on a separate sheet stating the name of the American Bankers Association transit number of the bank on which each item is drawn, and the amount. Each sheet should be separately footed, and where more than one sheet is used in listing items under either of the divisions, the totals of such sheets should be listed and footed on a separate sheet.

5. All items received before 2 o'clock p. m. (except on Saturday, when the hour will be 12 o'clock noon) will be credited on the day of receipt. Items received after these hours will not be credited until the following business day. All items, except those payable through the Chicago Clearing House, will be mailed at the close of each day to the member banks on which they are drawn. Member banks shall advise the Federal Reserve Bank of Chicago on the day of receipt that such items have been received and credited. Unpaid items not subject to protest shall be returned on the day of receipt, protested items shall be returned not later than the day after receipt. Returned items will be credited to the account of banks on which they are drawn and charged to the account of and returned to the banks from which received. Unpaid items shall not be held for any purpose whatsoever except for immediate protest.

6. In receiving the checks and drafts herein referred to, the Federal Reserve Bank of Chicago will act only as collecting agent of the sending bank, and will assume no responsibility other than due diligence until the funds are actually in its hands, and said reserve bank is authorized to send them for payment direct to the bank on which they are drawn, or for collection to another agent at its discretion. Banks receiving items from the Federal Reserve Bank of Chicago for collection shall be deemed the agent of the bank depositing such items with the Federal Reserve Bank of Chicago for credit.

7. Checks and drafts drawn on member banks which have joined the system may be stamped or printed across the face "Collectible at

paid through the Federal Reserve Bank of Chicago," but such indorsement shall never be held to import that the Federal Reserve Bank of Chicago, in accepting such checks or drafts for collection, has become the owner thereof or is acting otherwise than as the agent of the sending bank

8 Member banks which do not join the collection system at the time of its inauguration, may do so at any subsequent time. Member banks will be permitted, on 30 days' notice to the Federal Reserve Bank of Chicago, to withdraw from the collection system. The Federal Reserve Bank of Chicago may, at its discretion, withdraw the privileges of the collection system from any member bank which fails to observe these rules and requirements, or for other good and sufficient reasons.

On the 1st and 15th days of each month, all changes, if any, which have occurred in the list of members of the collection system since the preceding notice, will be published, and immediately thereafter the additions or withdrawals listed therein shall become effective.

9 No exchange charge will be made nor will any exchange charge be paid by the Federal Reserve Bank of Chicago in operating this collection system, which is a reciprocal arrangement for the mutual benefit of all member banks which join it.

(NOTE—The Federal reserve act provides that charges to be fixed by the Federal Reserve Board, may be imposed for the service of collection rendered by the Federal reserve banks. No charge will be made for the present, but if after experience in operating the collection system, a charge is found necessary, such charge will be imposed only after due notice and will not be retroactive.)

10 The Federal Reserve Bank of Chicago reserves the right to add to, alter, or amend these rules and requirements.

11 All items forwarded to the Federal Reserve Bank of Chicago shall be indorsed without restriction to the order of the Federal Reserve Bank of Chicago and show on each side of the indorsement the American Bankers Association transit number in prominent type.

RESOLUTION TO BE ADOPTED BY MEMBER BANKS

Whereas the Federal Reserve Bank of Chicago has announced its readiness to undertake for its member banks the collection of checks and drafts drawn upon its member banks, and

Whereas the said Federal Reserve Bank of Chicago has promulgated certain rules and requirements governing its conduct and the conduct of member banks in the operation of the collection system, which rules and requirements are as shown by copy thereof hereto attached, and

Whereas this bank desires to avail itself of the privileges offered by the said Federal Reserve Bank of Chicago and to join the collection system so to be established,

Now, therefore, be it resolved, That this bank hereby joins the said collection system of the Federal Reserve Bank of Chicago under the plan submitted by that bank in its circular letter, dated April 7, 1915, and hereby agrees with the said Federal Reserve Bank of Chicago and with such other member banks of the Federal Reserve Bank of Chicago as have joined or may hereafter join the said collection system, to be bound according to the terms of the rules and requirements hereto attached, and by such other rules and requirements as may be hereafter promulgated

And be it further resolved, That the cashier of this bank (or the secretary of its board of directors) is hereby directed to forward to the Federal Reserve Bank of Chicago a certified copy of these resolutions

I, the undersigned, do hereby certify that the foregoing is a true and correct copy of resolutions of the _____ duly adopted at a regular meeting of the board of directors of the said bank at _____ on the _____ day of _____, 1915, and that the said resolutions have not been rescinded or modified

In witness whereof, I have hereunto subscribed my name and affixed the corporate seal of the said bank, at _____ this _____ day of _____, 1915

[SEAL]

_____,
Cashier or Secretary of
Board of Directors

APPENDIX D TO CHAPTER XLVI

Following is Regulation J, Series of 1916, of the Federal Reserve Board on check clearing and collection, which superseded circular No 1 of 1916

FEDERAL RESERVE BOARD REGULATIONS ON CHECK CLEARANCES

The Federal Reserve Board is empowered, under section 16 of the Federal Reserve Act, to require each Federal Reserve Bank to—

“Exercise the function of a clearing house for its member banks”

In pursuance of the authority vested in it under the provisions of this section, the Federal Reserve Board, desiring to afford to both the public and the various member banks a direct, expeditious, and economical system of check collection and settlement of balances, hereby requires all Federal Reserve Banks to exercise the functions of

a clearing house for their respective member banks under the following general terms and conditions

Each Federal Reserve Bank will receive at par from its member banks checks* drawn on all member Banks, whether in its own district or other districts, and checks drawn upon nonmember banks when such checks can be collected by the Federal Reserve Banks at par

Each Federal Reserve Bank will receive at par from other Federal Reserve Banks checks drawn upon all member banks of its district and upon all nonmember banks whose checks can be collected at par by the Federal Reserve Bank. The Federal Reserve Banks will prepare a par list of all nonmember banks, to be revised from time to time, which will be furnished to member banks

Immediate credit entry upon receipt subject to final payment will be made for all such items upon the books of the Federal Reserve Bank at full face value, but the proceeds will not be counted as part of the minimum reserve nor become available to meet checks drawn until actually collected in accordance with the best practice now prevailing

(2) Checks received by a Federal Reserve Bank on its member banks will be forwarded direct to such member banks and will not be charged to their accounts until advice of payment has been received or until sufficient time has elapsed within which to receive advice of payment

(3) In the selection of collecting agents for handling checks on nonmember banks member banks will be given the preference

(4) Under this plan Federal Reserve Banks will receive at par from their member banks checks on all member banks and on nonmember banks whose checks can be collected at par by any Federal Reserve Bank. Member banks will be required by the Federal Reserve Board to provide funds to cover at par all checks received from or for the account of their Federal Reserve Banks. *Provided, however,* That a member bank may ship lawful money or Federal reserve notes from its own vaults at the expense of its Federal Reserve Bank to cover any deficiency which may arise because of and only in the case of inability to provide items to offset checks received from or for the account of its Federal Reserve Bank

(5) Section 19 of the Federal Reserve Act provides that—

* A check is generally defined as a draft or order upon a bank or banking house, purporting to be drawn upon a deposit of funds, for the payment at all events of a certain sum of money to a certain person therein named, or to him or his order, or to bearer, and payable instantly on demand

The reserve carried by a member bank with a Federal Reserve Bank may under the regulations, and subject to such penalties as may be prescribed by the Federal Reserve Board, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities. *Provided, however,* That no bank shall at any time make new loans or shall pay any dividends unless and until the total reserve required by law is fully restored

It is manifest that items in process of collection can not lawfully be counted as part of the minimum reserve to be carried by a member bank with its Federal Reserve Bank. Therefore, should a member bank draw against such items the draft would be charged against its reserve if such reserve were sufficient in amount to pay it, but any resulting impairment of reserves would be subject to all the penalties provided by the act

Inasmuch as it is essential that the law in respect to the maintenance by member banks of the required minimum reserve shall be strictly complied with, the Federal Reserve Board, under authority vested in it by section 19 of the act, hereby prescribes as the penalty for any deficiency in reserves a sum equivalent to an interest charge on the amount of the deficiency of 2 per cent per annum above the ninety-day discount rate of the Federal Reserve Bank of the district in which the member bank is located. The Board reserves the right to increase this penalty whenever conditions require it.

Member banks can at all times arrange to keep their reserves intact by rediscounting with their Federal Reserve Bank

(6) Each Federal Reserve Bank will determine by analysis the amounts of uncollected funds appearing on its books to the credit of each member bank. Such analysis will show the true status of the reserve held by the Federal Reserve Bank for each member bank and will enable it to apply the penalty for impairment of reserve

A schedule of the time required within which to collect checks will be furnished to each member bank to enable it to determine the time at which any item sent to its Federal Reserve Bank will be counted as reserve and become available to meet any checks drawn

(7) In handling items for member banks a Federal Reserve Bank will act as agent only. The Board will require that each member bank authorize its Federal Reserve Bank to send checks for collection to banks on which checks are drawn, and, except for negligence, such Federal Reserve Bank will assume no liability. Any further requirements that the Board may deem necessary will be set forth by the Federal Reserve Banks in their letters of instruction to their member banks

(8) The cost of collecting and clearing checks must necessarily be

borne by the banks receiving the benefit and in proportion to the service rendered. An accurate account will be kept by each reserve bank of the cost of performing this service and the Federal Reserve Board will, by rule, fix the charge, at so much per item, which may be imposed for the service of clearing or collection rendered by the reserve banks as provided in section 16 of the Federal Reserve Act.

CHAPTER XLVII

PREPARING FOR WAR

Looking Forward

From the very inauguration of the federal reserve system, the question had been present to all minds whether it was not probable that the United States would be drawn into the war. This question, of course, was the universal national preoccupation, but it was a source of anxiety to none more than to those who were in charge of the financial responsibilities of the government. They were keenly aware from past experience that the effect of war would be to enhance manifold the cost of conducting the government. It might also lead to almost indefinite liability for the expenses of European nations who were already carrying on hostilities. Thus from the beginning of the federal reserve system there was probably never a month in which the effect of the European war and its ulterior influences upon the American banking system, its possibilities for the future, and the best way for providing for contingent necessities, was not discussed more or less seriously by the members of the Federal Reserve Board. The strong attitude taken by President Wilson, however, on the subject of neutrality, the stern injunction that all members of the government should be scrupulously neutral even in thought, the apparent disposition of the President and of his Secretary of the Treasury to avoid anything that might be regarded as siding with one party to the controversy rather than with the other, at first prevented the formal consideration even of protective measures from and after the time when the first difficulties consequent upon the opening of the struggle had been met. When the system had been fully organized, when the banks of the country

had resumed payment, and when goods were at last freely moving to other countries, it seemed as if further consideration of financial organization for war might be deferred to the future

First Financial Approaches

But this quiescent condition could not last long. Various approaches had been made to the government, and indirectly of course to the federal reserve system, by those confessedly or otherwise interested in European affairs. On the other hand, great anxiety had been shown by organizations nominally interested in peace, but perhaps more concerned to promote the interest of one side or the other through subtle propaganda. Among the latter was a body known as Labor's National Peace Council, which met in Washington in the summer of 1915 and issued various warnings to the Federal Reserve Board concerning its prospective attitude toward belligerents and their loans. Labor's Peace Council was easily enough seen through and received no particular attention. But it soon appeared that the banks of the country had plunged deeply into European financing without waiting for the Board to say "yes" or "no." From time to time questions of eligibility of drafts had arisen but they had easily enough been "side-tracked" or evaded.

As the commitment of the banks to European transactions became more and more evident, the question of our attitude toward the financing of the war became more and more urgent. As seen at an earlier point, the first definite issue was reached in connection with the so-called French acceptance credit, but from that time onward the problem was presented in a recurrent form that made it practically constant. Acceptance credit after acceptance credit was arranged in New York, brought before the Board for approval, and freely allowed to go tacitly into effect. Only on a few occasions was it discussed and modifications suggested and introduced. The banks during the latter part of the year 1915 were obviously becoming burdened

with obligations which had been made for the purpose of facilitating the movement of war necessities, including actual munitions, to various countries. Yet the Board did not feel called upon to inquire into the destination of the goods or otherwise to interfere. The Department of State which had at first been inclined to hold that no war loans should be issued or placed in the United States, had practically reversed itself and had taken strong ground in favor of the right of neutrals to supply belligerents with materials which they chose to buy. This had been vigorously asserted and our views in the matter had been communicated to countries which had been disposed to complain of the trade in munitions. There was no reason why the federal reserve system should adopt a policy different from that of the government—indeed, it could not do so even had it chosen. Yet, from about the middle of 1915 onward, it was plainly seen that the time would come when there would no longer be any means of avoiding the question as to what the banking system of the country would do if a still heavier draft should be brought to bear upon it by the contending parties or if the United States itself should be drawn into the struggle.

First Decisive Action

The first decisive action on either of these questions was taken toward the close of the year 1916. From about the middle of that year, there had been a growing opinion that it would not be long before some positive step would have to be taken on the whole question of foreign financing. What this would mean no one was prepared to forecast, yet it was certain that the issue could not be much longer deferred. President Wilson's claim to having kept the country out of war had been approved by the country in a technical sense, yet perhaps there were few who believed in the actual or practical sincerity of the declaration. During the autumn of 1916, therefore, discussion as to the probable steps to be taken in

the event of war became a frequent, not to say a daily subject of debate, although without very positive action, and without definitely contemplating the putting of the financial system on a war basis

The first test of the position of the Board, and of the system in general, came in an unexpected way. Toward the close of the year 1916, European countries had been reaching what appeared to be the limit of their financial power. Their resources of taxation and their ability to float bonds would not be able much longer to withstand the terrible strain to which they were being subjected. They had already floated in the United States the Anglo-French loan of \$750,000,000. Further obligations on long-term bond or note account were not regarded as likely to succeed in this market. The investor was shy and wary, disposed to hesitate seriously before embarking his savings in European securities at any price. Yet among the banks there was a rather different attitude. Some of them were already greatly committed to European financing through holdings of acceptances, short-term notes, and obligations of various kinds. It was believed by the British government that it might succeed in placing in the United States, largely with the banks and more important investors, an issue of short-term Treasury bills which should be taken up periodically and redeemed out of the proceeds of new issues. Eventually the British government decided to place an indefinitely large issue of these bills upon the American market and arrangements to that effect were made with their fiscal agents in this country. It was obvious, however, that the success in floating these bills would not be great unless they were clearly recognized by the banks of the federal reserve system and, if possible, were made eligible for purchase by federal reserve banks themselves. It had been undoubtedly thought on this question that the Board would observe the same neutrality that it had adopted on other questions. But this hope was now to be disappointed. Wholly without warning and to the great disappointment of British

financiers, the Federal Reserve Board suddenly issued on November 28 a clear-cut warning to the financial community against the investment of its fluid funds in the new notes or bills

The Presidential Decision

It happened that at this particular juncture Secretary of the Treasury McAdoo was away from Washington on some official business and that President Wilson was taking an exceptionally active part in the direction of our diplomatic relations with other countries growing out of the war. Late in December a representative of a New York banking firm visited Washington, and having obtained by telephone an appointment with the Federal Reserve Board, engaged in general casual discussion of pending financial problems, finally closing, as he was about to leave the office, with the remark that the British Treasury had decided to offer its short-term bills on the New York market in the hope that they would be taken up by banks. When asked how large the issue of bills would be, the visitor responded that that would depend purely upon the absorptive power of the market. It was intended to issue them in any quantities that the market would absorb, and to take them up by reissuing more from time to time. No opinion was asked from the Board as to the desirability or legality of such action, or as to the eligibility of such bills at the reserve banks. The statement was merely made as a matter of information and with an evident degree of finality that such an issue of bills would be put out. This news was of a nature which unavoidably engaged the attention of the Board immediately and it was resolved to take the matter up directly with the President since the Secretary of the Treasury was out of reach.

A Board member visited the White House and explained the situation to President Wilson, who immediately directed the issuance of a strong statement, urging the banks not to purchase these bills on the ground that they represented an

unknown character of security which could not be counted as a liquid war asset. The President explained that the relations of the United States and Great Britain were at that time quite as delicate as were our relations with Germany, and that it was not desirable that our relationship with either should be complicated by unnecessary financial transactions if these could be avoided. The Board, upon hearing this definite message from the White House, immediately set about the preparation of a statement and in due time it was issued as follows:

In view of contradictory reports which have appeared in the press regarding its attitude toward the purchase by banks in this country of Treasury bills of foreign Governments, the Board deems it a duty to define its position clearly. In making this statement the Board desires to disclaim any intention of discussing the finances or of reflecting upon the financial stability of any nation, but wishes it understood that it seeks to deal only with general principles which affect all alike.

The Board does not share the view frequently expressed of late, that further importations of large amounts of gold must of necessity prove a source of danger or disturbance to this country. That danger, the Board believes, will arise only in case the inflowing gold should remain uncontrolled and be permitted to become the basis of undesirable loan expansions and of inflation. There are means, however, of controlling accessions of gold by proper and voluntary cooperation of the banks or, if need be, by the legislative enactment. An important step in this direction would be the anticipation of the final transfer of reserves required by the Federal Reserve Act to become effective on November 16, 1917. This date could be advanced to February or March, 1917. Member banks would then be placed on the permanent basis of their reserve requirements and fictitious reserves would be eliminated. The banks would thus have a clearer conception of actual reserve and financial conditions. It will then appear that while a large increase in the country's gold holdings has taken place, the expansion of loans and deposits has been such that there will not remain any excess of reserves, apart from the important reserve loaning power of the Federal Reserve Banks.

In these circumstances the Board feels that member banks should pursue a policy of keeping themselves liquid, of not loaning down to the legal limit, but of maintaining an excess of reserves—not with

reserve agents, where their balances are loaned out and constitute no actual reserve, but in their own vaults or preferably with their Federal Reserve Banks. The Board believes that at this time banks should proceed with much caution in locking up their funds in long-term obligations or in investments, which are short term in form or name but which, either by contract or through force of circumstances, may in the aggregate have to be renewed until normal conditions return. The Board does not undertake to forecast probabilities or to specify circumstances which may become important factors in determining future conditions. Its concern and responsibility lies primarily with the banking situation. If, however, our banking institutions have to intervene because foreign securities are offered faster than they can be absorbed by investors—that is, their depositors—an element would be introduced into the situation which, if not kept under control, would tend toward instability, and ultimate injury to the economic development of this country. The natural absorbing power of the investment market supplies an important regulator of the volume of our sales to foreign countries in excess of the goods that they send us. The form which the most recent borrowing is taking, apart from reference to its intrinsic merits, makes it appear particularly attractive as a banking investment. The Board, as a matter of fact, understands that it is expected to place the issues primarily with banks. These would appear so attractive that unless a broader and national point of view be adopted, individual banks might easily be tempted to invest to such an extent that the banking resources of this country employed in this manner might run into many hundreds of millions of dollars. While the loans may be short in form, and severally may be collected at maturity, the object of the borrower must be to attempt to renew them collectively, with the result that the aggregate amount placed here will remain until such time as it may be advantageously converted into a long-term obligation. It would, therefore, seem, as a consequence, that liquid funds of our banks, which should be available for short credit facilities to our merchants, manufacturers, and farmers, would be exposed to the danger of being absorbed for other purposes to a disproportionate degree, especially in view of the fact that many of our banks and trust companies are already carrying substantial amounts of foreign obligations, and of acceptances which they are under agreement to renew. The Board deems it, therefore, its duty to caution member banks that it does not regard it in the interest of the country at this time that they invest in foreign Treasury bills of this character.

The Board does not consider that it is called upon to advise private investors, but as the United States is fast becoming the banker of foreign countries in all parts of the world it takes occasion to suggest that the investor should receive full and authoritative data—particularly in the case of unsecured loans—in order that he may judge the future intelligently in the light of present conditions and in conjunction with the economic development of the past

The United States has now attained a position of wealth and of international financial power which in the natural course of events it could not have reached for a generation. We must be careful not to impair this position of strength and independence. While it is true that a slowing down in the process of credit extension may mean some curtailment of our abnormally stimulated export trade to certain countries, we need not fear that our business will fall off precipitately should we become more conservative in the matter of investing in loans, because there are still hundreds of millions of our own and foreign securities held abroad which our investors would be glad to take over, and, moreover, trade can be stimulated in other directions.

In the opinion of the Board it is the duty of banks to remain liquid in order that they may be able to continue to respond to our home requirements. The nature and scope of these requirements none can foresee. Such a course is moreover necessary in order that our present economic and financial strength may be maintained when, at the end of the war, we shall wish to do our full share in the work of international reconstruction and development which will then lie ahead of us. At that time there will be a clearer understanding of economic conditions as they will then exist and this will enable the country more safely and intelligently to do its proper part in the financial rehabilitation of the world.

This statement, it need hardly be said, was first submitted to the President and received his approval, his only comment being that it might well have been somewhat stronger.

Effect of Statement

The effect of the statement thus issued was electrical. It was tantamount to a warning to Great Britain not to use further the resources of our banks, and a notice to the whole world that the United States had by no means committed itself definitely to any specific position in regard to the war.

The news of the statement was telegraphed throughout the world almost immediately and gave rise to not a few interviews with the Ambassador of Great Britain, who bitterly regretted the action that had been taken and did not hesitate to express his opinion that the Administration had been induced to commit itself to the side of Germany. The decision was undoubtedly distasteful to the larger banks of the country which were already deeply engaged in war financing, and were the holders of considerable quantities of foreign paper. Both criticism and praise naturally were poured forth in great abundance with reference to the statement, and not a few of the President's officers were inclined to question the wisdom of the action taken. Among these was probably Secretary of the Treasury McAdoo, who returned to Washington shortly after the statement had been made public and was immediately concerned to learn the full details of it, although Mr. McAdoo made no known public or authentic comment on the subject.

The Countervailing Action

The doubt and hesitation which thus characterized our financial afterthought tended to crystallize into action of a countervailing kind. For some time past, there had been correspondence between the Federal Reserve Bank of New York and the Bank of England as to the advisability of establishing an agency relationship between the two. This correspondence had been undertaken largely at the instance of the Federal Reserve Board, which for some reason did not care to enter the negotiations itself. The outcome had been the expression of a willingness on the part of the Bank of England to act as agent of the federal reserve system and to transact such necessary business as that system might require. Corresponding service was to be rendered by the federal reserve system to the Bank of England, but in a tentative agreement it had been expressly specified that neither should enter the market of the other as a purchaser or seller of bills until after the war.

The agency arrangement was thus little more than what the term would imply in the strictest sense—a matter of convenience in handling routine business, such as the holding of gold. Even as to the wisdom of this there had been doubt in some minds, but the English Treasury bill episode probably tended to crystallize the determination to ratify this plan. Accordingly, just at the close of December, 1916, the Federal Reserve Board gave its approval to the tentative arrangement, and the Federal Reserve Bank of New York was directed to close the agreement with the Bank of England, it being understood that the Reserve Bank of New York would act on behalf of the other reserve banks, and that whatever transactions or services were needed on their behalf would be performed by and through the Federal Reserve Bank of New York. With this understanding, cable dispatches ratifying the agreement were exchanged and the plan was complete. Secretary McAdoo now thought that an announcement of this relationship would be desirable. This was for a variety of reasons, but among them, or perhaps the leading one, was the idea which prevailed in sundry quarters that Washington had “broken” with Great Britain and that our action on the Treasury bill issue had been designed to conserve our resources and to maintain a more perfect attitude of neutrality. He accordingly determined to have announcement made of the statement and gave directions to that effect.

Controversy with New York Bank

Notice therefore was conveyed in the usual official way to the federal reserve agent at New York, but that official happening to be out of the city, did not receive the notice until after it had been given to the public. It therefore seemed for a moment that the authorities at Washington had published the agreement which had been regarded as of a confidential character, without obtaining the consent of the Federal Reserve Bank of New York, or even of notifying it. The outcome was a

visit of a committee representing the directors of the Reserve Bank which came to Washington and secured an interview with the Secretary of the Treasury and the Federal Reserve Board

At this interview the committee protested against the action which had been taken, and when its protests met with no particular response it threatened the resignation of the directors. This attitude called forth a sharp rebuke from Secretary McAdoo, who indicated the serious state of our relationships with Great Britain which had in a measure dictated the announcement of the agency arrangements with the Bank of England. The committee finally left Washington and nothing further about the threatened resignation was heard, but the incident and the facts that were made public both by the Secretary of the Treasury and by others in connection with it, convinced the Board that our international position was far more threatening than had been supposed and that it would act wisely were it to make some definite preparations for possible war.

Putting the Banks into a War Condition

The actual problem of putting the banks into war condition was not one which could, as things stood, involve, for the time being, any elaborate or extensive action. Had it been definitely known that the banks were to be obliged to assume war functions great preparatory changes might have been made in their staff and other facilities, but of course the character of our participation, the nature of our financing, and practically all of the essential details involved in the operation could not be, and were not, known. About all that the federal reserve system could foresee was that our participation in the war would be practically unavoidable, and that with the Treasury in the weak condition in which it then was, the system would undoubtedly have to undertake very early financing.

That this would involve an immediate resort to reserve

banks was probable, but in view of the attitude of Secretary McAdoo as elsewhere described, in accordance with which he appeared to be disinclined to rely upon reserve banks any more than he could help, there was abundant grounds for the question just what part the reserve banks would play in the early financing of the war. This was a subject as to which no light could be obtained from the Secretary of the Treasury, and on which probably none was sought. The remaining field of work for the Board, therefore, was not large, and consisted primarily in making sure that there was an ample provision of federal notes designed to meet any emergency. In ordinary circumstances, it might have been thought well to accumulate gold or to put the portfolios of the banks upon a war footing. No such action was called for in this case because the banks were already upon an exceedingly narrow basis of operations. They could not well have been further curtailed in their volume of business and there was little to be asked with respect to the liquidity of their assets. Their reserves had been duly paid in so far as the law required, and while the Board had for some time recognized that it would be well if the period of reserve transfer could be promptly brought to a close, the entire funds being actually paid over, there was no direct warrant for asking any such thing at the time.

The resources of the banks were ample for any emergency that could reasonably be foreseen and the gold in their vaults was substantial and was being steadily augmented. A stiffening of examinations and the application of more rigid supervisory authority were perhaps advisable, and this policy was undertaken early in 1917 through the adoption of new examination and regulation requirements and through the slight expansion of the staff of examination. The printing of a reserve stock of about a billion dollars in federal notes was ordered and these notes were distributed early in 1917 to mints and sub-treasuries, where they could promptly be obtained in quantity as desired. The Comptroller of the Currency, who had

been steadily disposed to delay and interfere with the rapid distribution of notes, was induced to forego some of his obstructive tactics and to allow the custodianship of the notes to be changed as has been indicated, retaining of course all of the usual safeguards relating to the actual authorization of notes issued. Reserve banks were cautioned and encouraged in holding their staffs at a fairly full operating measure of efficiency, although this precaution promptly turned out, after our entry into the war, to have been of only minor significance since an enormous expansion of personnel was almost immediately necessary and had to be drawn from other banks without awaiting the slow process of absorption and training in the reserve banks themselves.

War Basis for Member Banks

It was far more important that the member banks should be placed upon a war basis than that the reserve banks should be, since the latter, as just seen, were in a fairly effective condition in any event. On the other hand, the difficulty of putting member banks into a war position was much greater. It was not possible to caution them in advance of the threat of war that could now fairly distinctly be seen, while it was known that many of them had assumed a rather extended position in the belief that it was their duty to finance the enormous export trade that had grown up. Indeed, a good many banks, both national and state, were unquestionably unsound as judged by strict standards, and, had we refrained from entering the war or had the Allies been seriously defeated prior to or perhaps after, our entry, the paper held in large quantities by not a few institutions might have turned out to be worthless or at least uncollectible for the time being. Exactly how much British and French paper there was in American banks in one form or another, perhaps could not be ascertained. It had assumed many subtle forms, partly through the acceptance methods referred to elsewhere, and partly as a result of direct

buying by agents in this country who gave their own obligations to banks, sometimes secured by foreign government bonds and sometimes otherwise protected, while in multifarious ways foreign bills of exchange, the obligations of foreign banks, bills drawn on foreign merchants, and short-term obligations of various descriptions issued by foreign governments, had been absorbed by investors, bankers, and private concerns in what afterwards appeared to be a very large degree

Not knowing how or in what relationship the United States would enter the war, it would have been almost out of the question for our banking authorities to have taken any very positive steps designed to reduce the amount of this paper or to rectify the conditions relating to the holding of it which had sprung up. Effort to do so would have precipitated a condition of serious anxiety, which in the circumstances the banking authorities were in no position to relieve. They could not have been expected to act merely upon conjecture, and there was at no time any indication from the administrative authorities at the head of the government which afforded any definite clue to probable future policies. Indeed, it could be questioned whether, up to a much later date than the opening of 1917, the administrative authorities themselves had made up their minds as to their proper course of action. Thus from the standpoint of the member banks definite financial action designed to cure or limit operations that might prove unsound, or whose omission might result in the strengthening of our banking system, was out of the question. In fact, with public opinion running as strongly as it then was on the side of the Allies, it might very reasonably have been assumed that our first financial policy after entering the war would prove to be exactly what in fact it turned out to be—the encouraging of exports of every kind of product and the financing of them through practically every banking institution that was willing to engage in the business

The Arrival of War

In this condition of uncertainty the federal reserve system continued during the winter and spring months of 1917, the eventual dismissal of the German Ambassador making still more certain what had come to be the general expectation—until, finally, as the result of presidential recommendation, Congress definitely declared war upon Germany on April 6, 1917. The fact that we had now definitely embarked upon the great conflict led immediately to a very thorough review of the financial situation at the hands of the Treasury Department and of the administration in general, and in this the Federal Reserve Board and banks were occasionally permitted or requested to join for the purpose of supplying technical information. The precise situation, as it was then revealed, must be studied in some detail if the subsequent necessities and policies of the federal reserve system are to be at all thoroughly understood. Such a survey may now be undertaken.

CHAPTER XLVIII

THE FEDERAL RESERVE SYSTEM AT THE OPENING OF THE WAR

Statistical Position

It is now necessary to attempt a brief survey of the position of the federal reserve system at the time of our entry into the European war. What has already been said has sketched the history of the system during the first two and one-half years of its service and has shown how the different strands of its policy were gradually drawn out and developed. Little or nothing has been said as to the actual condition that had been arrived at, nor has any reference been made, except casually, to relationships with the Treasury Department. It is therefore necessary, before proceeding further, to undertake a careful survey of the position which had actually been attained at the time, and to see how far this position indicated a preparedness for the struggle into which the organization was shortly to be plunged. In this analysis a beginning may be made to advantage by sketching the condition of the system at approximately the close of the year 1916 and the beginning of the following year.

It is worth while, as a beginning of the discussion, to set forth the statistical position of the twelve federal reserve banks at the beginning of the war. This was as follows:

RESOURCES AND LIABILITIES OF EACH FEDERAL RESERVE BANK AND OF THE FEDERAL RESERVE SYSTEM AT CLOSE OF BUSINESS APRIL 5-6

RESOURCES

Gold coin and certificates in vault	\$362,472,000
Gold settlement fund	200,125,000

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Gold redemption fund	2,505,000
Legal-tender notes, silver, etc	19,110,000
Total reserve	<u>584,212,000</u>
Five per cent redemption fund against federal reserve bank notes	400,000
Bills discounted—members	17,928,000
Bills bought in open market	82,735,000
United States bonds	36,629,000
One-year United States Treasury notes	23,042,000
United States certificates of indebtedness	50,000,000
Municipal warrants	15,207,000
Federal reserve notes—net	16,235,000
Due from other federal reserve banks—net	3,412,000
Uncollected items	146,422,000
All other resources	4,909,000
Total resources	<u>981,131,000</u>

LIABILITIES

Capital paid in	\$56,100,000
Government deposits	46,461,000
Due to members—reserve account	758,219,000
Collection items	105,436,000
Federal reserve notes—net	14,295,000
All other liabilities	620,000
Total liabilities	<u>981,131,000</u>

The Position of the Treasury

Quite as important as the position of the federal reserve system was the position of the Treasury Department. This would ordinarily not have been the case, and in normal circumstances a study of the federal reserve system would necessitate nothing in the way of outline or analysis of fiscal conditions. The fact, however, that within a few months the nation was to be plunged into war makes the condition of the Treasury of fundamental importance. Had the Treasury been in a strong position at the time of our declaration of war, the whole course of its financing might have been rather different, certainly during the initial stages. Its actual position, therefore, is worthy to be very carefully examined.

The following statement shows the status of the Treasury soon after the opening of 1917

THE SYSTEM AT THE OPENING OF THE WAR 1109

GENERAL FUND, FEBRUARY 28, 1917

Assets

Available gold	
Available silver dollars	
United States notes	
Federal reserve notes	
Federal reserve bank notes	
National bank notes	
Certified checks on banks	
Subsidiary silver coin	
Minor coin	
Silver bullion (available for subsidiary coinage)	
Unclassified (unsorted currency, etc.)	
Deposits in federal reserve banks	
Deposits in national banks	
To credit of Treasurer, U S	
To credit of other government officers	
Deposits in Philippine Treasury	
To credit of Treasurer, U S	
To credit of other government officers	
Total	

Liabilities

Treasurer's checks outstanding	
Deposits of government officers	
Post Office Department	
Board of trustees, Postal Savings System (5 per cent reserve)	
Comptroller of Currency, agent for creditors of insolvent banks	
Postmasters, clerks of courts, etc	
Deposits for	
Redemption of federal reserve notes (5 per cent fund)	
Redemption of federal reserve bank notes (5 per cent fund)	
Redemption of national bank notes (5 per cent fund)	
Retirement of additional circulating notes, act May 30, 1908	
Exchanges of currency, coin, etc	
Net balance	
Total	

RECEIPTS AND DISBURSEMENTS THIS DAY

Customs receipts		
Ordinary internal-revenue receipts		
Income tax receipts		
Miscellaneous receipts		
• Total ordinary receipts		
Panama Canal receipts		
Public debt receipts		
Balance previous day		
Total		

Ordinary disbursements		
Panama Canal disbursements		
Public debt disbursements		
Balance today		
Total		

\$ 47,374,958 83	\$ 3,757,421 61
19,599,134 00	17,902,193 81
12,921,749 00	5,174,165 77
1,850,005 00	1,452,081 33
90,240 00	18,799,894 59
17,634,127 64	
21,107 69	
5,037,994 38	17,656,376 29
1,346,375 38	400,000 00
4,819,429 50	23,075,184 78
1,012,599 16	3,953,670 00
13,382,366 56	10,353,886 08
32,730,783 00	\$101,624,874 26
5,205,852 58	66,505,398 57
915,945 15	\$168,130,272 83
4,187,604 96	
\$168,130,272 83	

\$ 550,558 52	\$ 2,863,674 74
494,833 95	80,085 28
71,904 55	95,400 00
183,818 33	66,595,398 57
\$ 1,301,115 35	
6,836 04	
25,000 00	
68,211,607 20	
\$ 69,544,558 59	

From a careful scrutiny of this statement two facts stand out—the first, that the Department was in a technically very weak condition, and the second, that its reliance upon banks was likely to be almost immediate because of the non-liquid character of most of its assets. Its general funds, which looked imposing on the surface, were to no inconsiderable extent made up of minor accounts, notes in process of redemption, and other items which could not be counted upon as an actual element in its spending power. Its banking balances were small, indeed, in the months immediately preceding they had often been drawn down to a point of practical exhaustion, and so non-profitable had they become to the depositaries that some of them had either requested the removal of deposits or had made plain their desire to be no longer troubled with them.

The Treasury Department had allowed itself to get into this position for a number of reasons, but perhaps the most important lay in the fact that in years past the Democratic Party had always been charged with extravagance or financial mismanagement resulting in bond issues. Bond issue in time of peace had come to be almost a conventional object of fear and was invested with a political tabu. So also, as concerned taxation, the party had no wish to be put in the position of materially adding to public burdens during peaceful times. Accordingly it had been a maxim of the Treasury Department during the early years of the Wilson administration to get along as best it could and not to contemplate the necessity of borrowing in any form unless such a course might be forced upon it as a result of the sternest necessity. Undoubtedly many members of the administration had hoped against hope to the very last that we might continue the policy of keeping out of war, while even those who neither hoped nor expected that we should thus remain free could not permit themselves by any act or sign to show to the public that they were making preparations for war. These factors combine to explain the peculiarly weak position in which the Treasury Department

found itself during the opening months of 1917. The current of exports from Europe to the United States had gradually dwindled as the manufacturing power of Europeans became less, and our tariff revenues had suffered correspondingly. Thus, even had we not entered the war, some kind of legislation, or some action looking to the borrowing of money, would have been necessary.

The Reserve System and the Treasury

It is now necessary to go back a few months, in order to trace the history of what was to become perhaps the most important element in the relationship between the federal reserve system and the Treasury Department. This was the provision of the Federal Reserve Act in connection with public deposits. Before the Reserve Act had been drafted, it had been one of the commonest complaints against the older banking system that it so inadequately provided for the fiscal operations of the government. The practice of insisting upon payment largely in cash, and of disbursing cash principally, had long been obsolete and injurious. It is not necessary to comment further upon the details of the older system, especially as they have been outlined in some detail in an earlier chapter.¹

It should, however, be recalled at this point that, when the Federal Reserve Act was under advisement, all of the criticisms which had in former years been formulated with respect to Treasury relationships were given a very careful survey, the result being that the act contained in its original form a complete provision for transferring government funds entirely to the reserve system and for constituting the reserve banks fiscal agents. This provision had early provoked the dislike of the Secretary of the Treasury, who had secured its modification in such a way as to make his use of the reserve system

¹ See Book I, Chapter II

permissive rather than compulsory. After the organization of the reserve system, it was found that the Treasury financial hierarchy, always jealous of its own prerogatives and powers, was especially fearful of the loss of functions. Such fear was manifested on various occasions by the officials of the Treasurer's office, while among the sub-treasuries themselves the Reserve Act had caused a feeling of apprehension. Out of this grew the general effort to impress upon politicians the undesirability of any early transfer of funds to reserve banks, or any early action which would place upon such banks very serious responsibilities in the handling and transfer of public funds.

Needless to say, it was not deemed expedient to base such argument upon any theoretical or abstract grounds, but it was usually founded upon the assertion that the reserve banks were still in an elementary stage of organization and that they had not yet developed the necessary machinery which would enable them to deal effectively with the government's deposits and transfer needs, still less to act as fiscal agent in the full sense of the term. There was a small measure of truth in this assertion, although it was also true that nearly all of those who were likely to require the services of reserve banks adopted a like point of view, so that, had it been granted full vent, there would have been no reason to think that the banks would ever have obtained any opportunity to perform their chief functions.

Treasury and the War

Indeed, a farsighted administration of the Treasury, recognizing our possible advent into the war, ought to have developed the fiscal machinery of the reserve banks at as early a date as possible. This, however, was not done.² Secretary McAdoo listened undoubtedly to the fears of the subordinate officials of the Treasury Department and of the sub-treasury

² The whole question was forcefully expressed to Mr. McAdoo in a thorough report, dated July 15, 1915, transmitted to him by the Board. See Appendix B to this chapter.

system, and the result was to crystallize in his mind the determination to postpone as long as possible the shift from the old sub-treasury system to the reserve banking system. Congress, however, had formed a very distinct opinion that the transfer was to become effective at an early date. This had been stated in the course of the discussion of the Reserve Act, and it had then been argued that such transfer would result in a large saving to the government. The situation offered some possibility of political annoyance, for the Republicans were not averse to seeing the Democratic administration deprived of the valuable "plums" which were afforded by the sub-treasury system. It was not long, therefore, before questions began to arise in Congress as to the reasons why the Treasury Department made no motion to comply with the provisions of the Reserve Act in connection with fiscal agency duties. When appropriation bills came up, the question was raised as to whether it would not soon be true that Congress could cease to appropriate money for sub-treasuries.

These questions at first were not pressing, since it was recognized that time must be granted for the full working out of so great and complex a system as that provided in the Federal Reserve Act. But the queries eventually became more insistent, and in order to meet them, Secretary McAdoo, at the close of the year 1915, advised the reserve banks that he had resolved to shift to them all funds then held by national banks in those cities in which reserve banks were situated. This left the great body of "pet banks," numbering about 1,500 throughout the country, which were the principal sources of political patronage in the use of Treasury funds, undisturbed, for their inactive deposits were not touched and the Treasury announced that there would be no change in their status. The Department would continue to use the active balances in the principal cities but would use them through the reserve banks instead of through the national bank depositaries. As the

funds of the Treasury were at that time in low condition, this announcement bade fair to place upon the reserve banks a considerable amount of more or less expensive work without the acquirement of any net deposit balances that would be of value. Accordingly, some members of the federal reserve system were inclined to protest in a quiet way at the action of the Department, largely because of its incomplete and partial nature. Better counsels prevailed, however, and general preparations were promptly made, the funds of the government in the cities named, amounting to about \$8,436,000, being turned over to the various institutions on or about January 1.³

An Incomplete Reform

It will be observed that this action not only failed to transfer the principal volume of the government funds, but it entirely ignored the fiscal agency function of the banks, leaving that to be worked out later as circumstances might demand. The action taken was undoubtedly little more than a concession to criticism in order that it might be possible to reply to such critics that the Department had already taken the necessary steps toward constituting the reserve banks' active depositaries. It apparently had no direct bearing upon the war situation at all. This state of affairs was shortly perceived in Congress, and when the appropriation bill of 1917 was under advisement, the demand for the abolition of the sub-treasuries became a good deal more insistent than had ever been true on former occasions. As a result a committee was eventually appointed to consider the question whether the sub-treasuries should or should not be transferred, and application was made to the Secretary of the Treasury for his opinion on the subject. The result was to call forth from Mr. McAdoo a very pointed answer which was transmitted to Congress and which distinctly requested the maintenance of the sub-treasuries with

³ The Federal Reserve Bulletin for December, 1915, published Secretary McAdoo's order, as given in Appendix A to this chapter.

their existing staffs and declared against any more extensive employment of reserve banks in performing these functions⁴

The Treasury, in short, up to the time of our entry into the war had shown itself in every way disinclined to accept in full faith and to act upon the extensive provisions for the management of its deposit and fiscal agency functions. Not only was this true, but it had refrained from employing the gold settlement fund in its extensive transfers throughout the country, using the fund only very sporadically or occasionally, notwithstanding that the fund itself from the beginning relied in a measure upon the sub-treasuries to facilitate its work, since the gold representing the fund was stored in the vaults of these sub-treasuries. The gold settlement fund, indeed, so far as the physical custody and transfer of money was concerned, had from the start been more largely under the control and direction of the Treasury Department and had more extensively depended upon the facilities of the Department than it had upon the reserve banks. Yet it was regarded as an undesirable innovation, one which might readily work destruction to the number of places and employees, or which might shift the control of an important piece of financial machinery to the reserve banks and out of the hands of government officers.

First Financial War Measures

When war was definitely determined upon, therefore, and the announcement made known to the public, it was apparent that an extensive program of Treasury financing would be unavoidable. The federal reserve system looked with anxiety to the Secretary of the Treasury for light as to his probable intent, but no information was furnished and no outline of any plan supplied until on March 31 information was suddenly given to the system that the Secretary desired to float an issue of \$50,000,000 of certificates of indebtedness at 2 per cent

⁴ See Appendix C to this chapter. This letter was originally printed as a House Document, and was then reprinted in the Federal Reserve Bulletin for February, 1917.

The figure thus offered appeared extraordinarily low and the evident intention that this issue of certificates should be promptly taken up by the reserve banks themselves through direct purchase, was naturally regarded as a reminiscence of the bad measures of financing employed by Secretary Chase at the opening of the Civil War. True, the reserve banks were amply able to take up the \$50,000,000, and they were more than able to finance them without loss to their reserves, since the nation now had the inestimable advantage of using bank credit facilities instead of exacting the payment of such loans into the Treasury. Nevertheless, the two features of unfairness or unwisdom—abnormally low rate of interest offered and the flat proposal to put the certificates into reserve banks, since no others would evidently be willing to buy at that rate of interest—elicited more or less direct criticism, and accordingly the rate was raised to $2\frac{1}{2}$ per cent, at which figure the reserve banks took and carried practically the entire issue throughout its life of six months.

A Danger Averted

A great danger was apparent in this first financial undertaking set on foot by the Treasury. It was seen in the belief that the federal reserve banks should and could take government securities at a very low rate of interest and practically for cash, placing their funds at the disposal of the Secretary of the Treasury for his immediate uses. This danger was really twofold, since both phases of the plan were erroneous and dangerous. Such loans at reserve banks were absolutely without warrant, save perhaps as a last resort after all other means of getting funds had failed. To place them with the reserve banks at a purely nominal rate of interest could not be defended from any standpoint and was bad for the public, bad for the banks, and only technically beneficial to the Treasury.

There was some apparent indication that Secretary McAdoo, at the time, contemplated an extensive plan of short-

term bank financing in which he would—as Secretary Chase did during the Civil War—obtain his funds directly from financial institutions, leaving them to take care of themselves as best they could. Whatever leanings he may have had in this direction, it is fair to say, were soon overcome, at least in part. The economists and financiers of the country took a very strong position in favor of heavy taxation by Congress, believing that only through such taxation could the situation be really met and inflation kept within check. The bankers of the country were theoretically inclined to favor this same view in favor of taxation, with borrowing only as a secondary resource, and yet there was a weak-kneed disposition among them to lean toward inflation and large government loans as a means of providing for necessities. This disposition appeared more clearly as the weeks went by, and in various conferences which the Treasury held with bankers from time to time there was a tendency to impress the opinion that popular loans and taxation were a resource which was very strictly limited by conditions, and that the easiest and perhaps most favorable plan within reach was that of depending more and more upon inflationary measures.

Acceptance of Inflation

It was not for some months, however, that the definite acceptance of inflation as a means of war financing became general. During the first few weeks after the declaration of war, members of the Federal Reserve Board still had a certain amount of influence with the Secretary of the Treasury, and exerted themselves as far as they were able to the neutralizing of the drift toward an inflation policy bottomed upon the use of reserve banks as a means of supplying funds in the form of bank credit. Secretary McAdoo, in fact, undertook not to “unload” anything further upon the reserve banks, certainly, not without notice, and in consideration of his attitude in the matter it was agreed that every effort should be made to bring

about a satisfactory organization for shifting Treasury requirements to member banks and through them to the public

It was not long before an announcement from the Treasury pretty definitely outlined the methods which were to be pursued, and while there was still some talk of low rates of $2\frac{1}{2}$ and 3 per cent, it was apparent to all that this was merely a means of transition from the early effort to get money out of the banks to a more satisfactory plan of management. The fact that a working entente had been established between the Board and the Treasury was made apparent in the announcement of April 21, 1917, when the Board made public the fact that it had asked reserve banks to do their utmost to facilitate the sale of certificates and "to impress upon the banks" of the several districts "the importance of this offer," and endeavored furthermore "to enlist their hearty co-operation."⁵ It was understood that so soon as practicable arrangements would be made to fund this issue of certificates which had been authorized by the War Bond Act, signed by the President on April 24, into an issue of bonds authorized by the same act on which the rate of interest was fixed at $3\frac{1}{2}$ per cent, while an aggregate of \$7,000,000,000 was permitted to issue. This, therefore, constituted the germ of the war financing system, and it was through later expansion of the ideas presented in this first circular and the documents which accompanied it that the highly complex system of Treasury offerings eventually assumed its ultimate form.

A Change of Treasury Opinion

The recognition on the part of officers of the Treasury that they were now definitely working with the federal reserve system under a general basis of understanding which implied the effort on the part of reserve banks to get funds from members and to sustain members through advances to them in taking up certificates, the latter eventually to be funded into

⁵ See Appendix D to this chapter

bonds, gave members of the Treasury Department a new view of some things which had formerly been looked upon by them in a rather reactionary way. The most important of these things for the immediate purpose was the gold settlement fund. As elsewhere noted, the tendency in the Department had been to view this fund as an interloper, which, working in conjunction with the public deposit plan, might eventually operate to destroy the sub-treasury system and to render the transfer of funds from one part of the country to another both easy and "unsafe." No sooner, however, had some conception been formed of the magnitude of war financing than it became apparent that to attempt to obtain subscriptions from banks in Iowa, North Dakota, or California, and to have these subscriptions remitted either to Washington or to New York, or even to designated depositaries in the immediate neighborhood, would bring about transfers of bank funds in a volume which would simply be out of the question, and which, if attempted, would completely upset the whole financial structure of the nation. Gradually, therefore, there was evolved in the minds of the Treasury officials the idea of leaving Treasury funds on deposit with the banks which subscribed for bonds or which obtained subscriptions from their customers, transferring these funds, when they were needed, to reserve banks from which they would be promptly checked out in settlement of interest and other obligations.

Thus by a certain stretching of the terms of existing law the entire body of banks in the United States were to be used as depositary banks, while the reserve banks were to act as local collecting and disbursing agencies, thus for the first time truly fulfilling their functions as fiscal agents. Remembering that many banks when hard pressed would necessarily have to resort to reserve banks for rediscount accommodation in order to meet their subscriptions, it is obvious that what the Treasury now planned was to recognize the reserve institutions in the fullest sense as fiscal agents. Such operation on the part of

the reserve banks, of course, would be out of the question were there not some means of clearing and offsetting the enormous payments and subscriptions coming from all parts of the country, and this obviously was entirely within the power of the gold settlement fund. Neither shipments of coin nor of notes, nor even remittances to some central point would be necessary, but the government, by using the reserve banks as collecting and disbursing agents, would simply gather in the proceeds of subscriptions in all parts of the country, which in turn it would gradually pay out there in settlement for the grain, the horses and cattle, the manufactures, the cotton, and the other products which must be obtained in order to satisfy the war needs of the United States and its allies. So, under the compulsion of events, the gold settlement method of transfer and the adoption of credit methods of payment as against specie made their way into actual use. Had there been no such compelling necessity, it may well be questioned whether we should not today still be working, nationally speaking, upon the old sub-treasury system with but little modification.

APPENDIX A TO CHAPTER XLVIII

FEDERAL RESERVE BANKS AS FISCAL AGENTS

(Federal Reserve Bulletin, December, 1915)

The Secretary of the Treasury has sent the following letter to the Federal Reserve Board, as result of which Federal Reserve Banks will become fiscal agents on January 1, 1916

November 23, 1915

The Federal Reserve Board,
Washington, D C

Gentlemen In accordance with the provisions of section 15 of the Federal Reserve Act, which provides that—

“The moneys held in the general fund of the Treasury may, upon the direction of the Treasury, be deposited in Federal Reserve Banks, which banks, when required by the Secretary of the Treasury, shall act as fiscal agents of the United States,”

I have determined to appoint the Federal Reserve Banks depositaries and fiscal agents in the manner thus indicated by the Act. In order that the reserve banks may not be embarrassed by the addition of an

unduly large volume of business upon undertaking their functions in this connection, I have decided to make a beginning by transferring to each of the Federal Reserve Banks the funds of the Government now on deposit with the national banks in each of the cities in which a bank is located, thus giving to each of the reserve banks the funds held by the national banks in its own city. Each Federal Reserve Bank will be required to perform on behalf of the Government the services which are now rendered by the national-bank depositaries located in said cities, as well as any other services incident to or growing out of the duties and responsibilities of fiscal agents.

May I ask you to cooperate in carrying out the provisions of the Federal Reserve Act in this regard and to take any and all steps that may be desirable to perfect such arrangements by the Federal Reserve Banks as will enable them to fully and satisfactorily perform these functions from and after January 1, 1916, the date on which it is my purpose to make the proposed arrangements effective? I have designated Hon. William P. Malburn, Assistant Secretary of the Treasury, in charge of the fiscal bureau, to act for the Treasury Department in carrying out the details so far as this department is concerned. I have deferred action until this time, in order that the organization of the Federal Reserve Banks might be completed and gotten into good working order through experience and practice, and with the hope that a satisfactory clearing and collection system would, by this time, have been evolved. I feel convinced, however, that I should not longer delay giving these banks the opportunity of performing these services for the Government and enlarging their field of usefulness.

Very truly yours,

W. G. McAdoo, Secretary

It is estimated that the following amounts may be transferred to the several Federal Reserve Banks

Boston	\$ 796,000
New York	1,437,000
Philadelphia	1,175,000
Cleveland	285,000
Richmond	425,000
Atlanta	520,000
Chicago	1,436,000
St. Louis	850,000
Kansas City	655,000
Minneapolis	225,000
Dallas	191,000
San Francisco	441,000
Total	\$8,436,000

APPENDIX B TO CHAPTER XLVIII

REPORT ON USE OF RESERVE BANKS BY THE TREASURY

July 15, 1915

To The Federal Reserve Board,

Washington

Gentlemen

Your Committee was appointed to formulate a report stating briefly the reasons which make it desirable for the Secretary of the Treasury at an early date to designate the Federal Reserve Banks to act as fiscal agents of the United States, as authorized in Section 15, of the Federal Reserve Act

The first paragraph of Section 15 reads as follows

"Sec 15 The moneys held in the general fund of the Treasury, except the five per centum fund for the redemption of outstanding national-bank notes and the fund provided in this Act for the redemption of Federal reserve notes may, upon the direction of the Secretary of the Treasury, be deposited in Federal reserve banks, which banks, when required by the Secretary of the Treasury, shall act as fiscal agents of the United States, and the revenues of the Government or any part thereof may be deposited in such banks, and disbursements may be made by checks drawn against such deposits"

Pursuant to the request aforesaid your Committee offers the following memorandum

First There is nothing which the Secretary of the Treasury could do which would contribute so much to the prestige of the Federal Reserve System as to designate the Federal Reserve Banks to act as fiscal agents While it is recognized that Mr McAdoo, as an individual and officer of the Government, has taken a very prominent part and has shown an active personal interest in the passage of the Federal Reserve Act, he has not, as yet, in his official capacity, done the one thing which, above all others, would show to the world the confidence the United States Government has in the system

Second The practice of locking up in the Treasury large amounts of money is a clumsy and unscientific method, long since abandoned by other nations Like sums in the Federal Banking System would be of much greater potency

Third While the Federal Reserve Act does not abolish the Sub-treasury System, yet it was clearly the intent of Congress that the chief functions of the Sub-treasuries would be gradually taken over by the Federal Reserve System If, therefore, the Secretary of the Treasury should require the Federal Reserve Banks to act as fiscal

agents, such action would not necessarily imply that he contemplated the abolition of the Sub-treasuries, for the reason that, as has been pointed out at various times, the Sub-treasuries must still perform certain important functions, to wit (1) The custody of gold and silver coin on account of various reserve and trust funds of the United States and, (2) the redemption and exchange of gold and silver certificates

Fourth The creation of a central clearing fund in Washington by the twelve Federal Reserve Banks, through which all transactions between the Federal Reserve Banks may be cleared once a week, offers a most advantageous plan for the easy and prompt handling of Government fiscal transactions. A very simple *modus operandi* might be developed if the Treasurer of the United States were to become a special participant in the operations of this clearing fund. All fiscal transactions of the Government could then be readily cleared on the books of the fund. Under this plan, all receiving and disbursing officers of the Government would keep accounts, either with a Federal Reserve Bank or a Reserve Branch Bank and whenever it was desirable to keep an account at a point where there was no Reserve Bank or with any member National bank. These accounts would be cleared through their Federal Reserve Banks and the Central Gold Clearing Fund.

Fifth The employment of the Federal Reserve Banks as fiscal agents, by discontinuing the use of National bank depositaries, would greatly simplify Government records and Treasury accounts. At most, the Treasurer would be required to keep twelve accounts in the Continental United States instead of some 1,500 deposit accounts, of which 850 are active. It is conceivable that, with the Central Clearing Fund, these twelve might be still further reduced to a single account, operating through the Central fund.

Sixth While the Federal Reserve Banks are admirably constituted to act as fiscal agents of the Government, it is decidedly undesirable from the standpoint of the Federal Reserve Board that they should be *required* to act in this capacity unless the Secretary of the Treasury feels reasonably certain that this is a wise, permanent policy. The fact that it means the deposit of 250 to 300 millions of dollars with the Federal Reserve Banks means that the Secretary's action will add greatly to the power of the Federal Reserve Banking System, for the reason that every dollar deposited with the Federal Reserve Bank is, after allowing 35 per cent reserve against deposits and 40 per cent reserve against note issue, potentially capable of an additional

expansion of \$162 50 for every \$100 deposited. It is for the Secretary of the Treasury, therefore, to determine whether the funds in his charge shall be deposited in National banks as at present, or in Federal Reserve Banks where their potentiality for the good of the general public is very greatly enhanced.

The service which the Federal Reserve Banks can render to the Treasury is an important one and should be effective in reducing expenses in all sub-treasuries as well as in the Treasury Department itself. It will, of course, add very largely to the expense of the Federal Reserve Banks and for that reason as well as for others should not be entered into unadvisedly.

Seventh. Under the Acts creating the First and Second Banks of the United States, these banks acted as fiscal agents and depositories of all government funds. This is true of the great banks of all nations and constitutes the chief functional relation between the banks and the government. Under the National Banking Act of 1863 the necessities of the Federal Government growing out of the Civil War were the chief subjects of concern and therefore the National Banking System, then established, was created to make a market for Government bonds and to base an issue of National Bank currency on those bonds, at the same time taking away from State banks by taxation the right to issue bank notes. The Federal Reserve Act has created a new form of currency, based on commercial paper and a method which will gradually absorb United States Government bonds having the circulating privilege and replace National bank notes with the Federal Reserve notes, and Federal reserve bank notes. The reason for the existence of the National banks under the law can in future no longer be predicated upon the need of supporting Government credit, but must depend for constitutional basis upon the necessities of commerce between the States and the fiscal requirements of the Government.

If, as your Committee believes, it is of very great importance to preserve the integrity of the National Banking System *per se* and not to rely upon the Federal Reserve System with a membership consisting solely or chiefly of State banks and Trust companies, it is clearly most desirable that the Federal Reserve Banks shall be named fiscal agents of the United States as soon as possible.

In conclusion, it is proper to say that your Committee does not suggest that this change be effected, except with careful thought and preparation. It is apparent from the study given the subject that, although the Federal Reserve Banks can undoubtedly take over many

of the important functions of the Treasurer's office and of the Sub-treasuries the work must be undertaken gradually and only after careful and thorough study of just what is to be done and finally accomplished. It would probably take fully a year and perhaps nearly two years to carry this out in an orderly way and your Committee does not believe that the Board would be justified in undertaking the working out of these details unless the Secretary of the Treasury had considered the problem in its general aspects and decided whether he was favorable in a general way to the proposal.

Your Committee has been glad to avail itself of the services of Mr. Herbert S. Woods, Acting Chief, Division of Efficiency, United States Civil Service Commission, which under the direction of Assistant Secretary Malburn, has been making special study of Treasury Bureaus, and we append for the information of the Board three separate memoranda prepared by Mr. Woods as exhibits. Your Committee has gone through these memoranda in some detail with Assistant Secretary Malburn and while it is not prepared to endorse all the recommendations as made and ventures to disagree with some of these suggestions, still these memoranda will be very useful to the Board or to any future Committee in working out the details.

Respectfully submitted

(Signed) F. A. DILLANO,
W. P. G. HARDING

EXHIBIT 'A'

In response to your recent oral request for suggestions regarding the designation of Federal Reserve Banks as fiscal agents of the United States there is submitted herewith an outline of the functions of the Treasurer of the United States and the Government depositaries, with a discussion of the feasibility of the Federal Reserve System's taking over these functions and of the possible ways of doing it. As a result of these considerations we venture the suggestion that the Board content itself for the present with requesting that the Reserve Banks be designated as Government depositaries and that at least a majority of the National bank depositaries be discontinued. We believe that the Board can then develop a system that will make inevitable the discontinuance of the remaining depositaries and even of the sub-treasuries, and the transfer to the Board of a large part of the work now done in the Treasurer's office at Washington.

TREASURY ORGANIZATION AND FUNCTIONS

The fiscal business of the Government is now carried on by (1) the Treasurer of the United States and (2) Government depositories of three classes—(a) 11 mints and assay offices, (b) 9 sub-treasuries and (c) nearly 1,500 depository banks, of which 850 have active Government accounts and the remainder inactive accounts

The Treasurer is the banker of the Government. He is the custodian of deposits made for (1) the Secretary of the Treasury as chief fiscal officer of the United States, (2) Government disbursing officers, who maintain about twenty-one hundred active accounts, (3) the Post Office Department and the Board of Trustees of the Postal Savings System, (4) the Comptroller of the Currency as agent for creditors of failed National banks, (5) Federal Reserve Banks and National banks, who deposit funds with the Treasurer under the laws that make him agent for the redemption of the notes of these banks, (6) postmasters, who deposit postal funds to their own credit, and (7) clerks and other officers of courts who deposit to their own credit funds in the custody of the courts. Of these accounts those of postmasters (6) and court officers (7), with balances aggregating about \$15,000,000, are kept on the books of the sub-treasuries and depository banks. The accounts of other depositors are kept on the books of the Treasurer of the United States in Washington. Deposits for credit in these accounts are received at sub-treasuries and depository banks, credited to the account of the Treasurer and reported daily to Washington where they are charged to the depositories and credited as directed by the depositors. Similarly, warrants and checks against these accounts are cashed at sub-treasuries and depository banks, charged to the account of the Treasurer and remitted daily to Washington, where they are credited to the depositories and charged to the drawers.

In addition to the accounting officer there are attached to the Treasurer's office at Washington the Cash Room, the Redemption Division (for gold and silver certificates and United States notes) and the Redemption Agency (for Federal reserve notes and National bank notes).

The Cash Room and the Redemption Division form together the equivalent of a sub-treasury, but in addition the Cash Room has charge of the reserve stock of gold and silver certificates and United States notes, and furnishes the various sub-treasuries with the certificates and notes needed to effect exchanges.

The mints and assay offices are the depositories for the greater

part of the coin and bullion held to redeem gold and silver certificates United States notes and Treasury notes (the remainder being in the sub-treasuries) This coin and bullion is transferred to other depositaries on order of the Secretary or is paid out to persons depositing at the sub-treasuries currency and coin for redemption or exchange.

Besides being agents of the Treasurer for the receipt of deposits and the cashing of checks, the sub-treasuries act as agents for the redemption and exchange of gold and silver certificates United States notes Treasury notes and minor coin Deposits of currency and coin for redemption and exchange are usually received subject to count and are paid for by the most convenient Treasury office as soon as the amount of the deposit is verified In the meantime the deposits are carried on the books of the several Treasury offices as liabilities.

Only a small part of these transactions are redemptions of paper currency in coin or bullion By far the larger part of the redemption and exchange business consists in exchanging one denomination of paper currency for another and issuing new currency to replace that which has become unfit for circulation.

It will thus be seen that the offices under the Treasurer's supervision perform a number of distinct functions.

(1) Keeping accounts of moneys deposited for the United States, the disbursing officers of the Government the Post Office Department, etc and of the distribution of these moneys among the various depositaries.

(2) Receiving and keeping deposits to be credited to the accounts mentioned above, and cashing warrants and checks to be charged thereto.

(3) Keeping reserve stocks of the United States Paper currency, and exchanging one kind of denomination of such currency for another, and "fit for 'unfit' currency.

(4) Holding coin and bullion for the redemption of United States paper currency, and making such redemptions on demand.

(5) Holding the five per cent redemption funds and redeeming Federal Reserve notes in gold and National bank notes in lawful money.

FUNCTIONS THAT FEDERAL RESERVE SYSTEM CAN ASSUME

The Federal Reserve System can legally take over all of these functions except the last two which must be retained by the Treasurer since the law does not permit the various redemption funds to be deposited in the reserve banks About the assumption of the strictly banking functions of receiving deposits, paying checks and keeping

depositor's accounts there can be no question. The Reserve Banks can also, if they so desire, provide themselves with adequate stocks of United States paper currency and make exchanges for their member banks, as each National bank does to a limited extent for its customers. Moreover, there seems to be no legal reason why the Secretary of the Treasury should not designate the Federal Reserve Agents as custodians of reserve stocks of gold certificates, silver certificates and United States notes just as they are now custodians of the reserve stocks of Federal Reserve notes. If this were done the Federal Reserve Agents might make exchanges of currency to an unlimited extent for the reserve bank to which they are attached. If they received their currency supplies directly from the Bureau of Engraving and Printing, the Treasurer would be practically eliminated from exchange transactions.

The Reserve Banks can also reduce to a minimum the work of the Treasurer in connection with the redemption of Federal Reserve notes and National bank notes by redeeming in gold, on demand, not merely their own notes but also those issued by other reserve banks, and by redeeming National bank notes in lawful money for their member banks. They can sort redeemed bank notes into those fit for circulation and those unfit, treat the fit like paid checks of the issuing banks and make at least a partial sort of the unfit before remitting them to Washington. On their receipt in Washington the Treasurer might instead of paying for them, authorize the Reserve Bank to make the proper charges against the banks whose notes had been redeemed, or, if such banks belonged to other Reserve districts, against their Federal Reserve Banks. The 5 per cent redemption fund would then remain in the Treasurer's custody practically intact, since most banks would find it more convenient to send notes to their Federal Reserve Bank for redemption than to the Treasurer.

When this condition has been brought about it would seem that Congress might easily be persuaded to repeal the law directing banks to make their 5 per cent deposits with the Treasurer, and require these deposits to be made instead with the Federal Reserve Banks. If, also, the Treasurer did not have Federal Reserve notes presented to him for redemption it would soon become apparent that the deposits with the Treasurer for the redemption of Federal Reserve notes were unnecessary.

The Reserve Banks can also assist, if they wish to, in the redemption of United States paper currency in coin and bullion. They can do this in two ways

(1) By receiving deposits of paper currency for redemption certifying the amount to the nearest Treasury office having a supply of the coin or bullion desired, and then remitting the currency to Washington for cancellation if unfit for circulation or for return to reserve stock if fit

(2) By providing themselves with adequate stocks of coin and bullion and making redemptions themselves for accommodation of their member banks. Under this plan they might be compelled at times to present the redeemed certificates to Treasury offices in exchange for coin or bullion, but it seems probable that this would not be generally necessary, as the gold taken in would probably in the long run almost equal the gold paid out

There would of course be no advantage to the Reserve Banks in assuming these redemptions and exchange functions except as it would strengthen their position and give them good grounds for claiming the largest possible amount of Government deposits. It might also facilitate the substitution of Federal reserve notes for United States paper currency, since the banks would sometimes be able to pay out Federal reserve notes in exchange for gold certificates, silver certificates and United States notes. They might also prevent the issue of additional gold certificates to replace those which are redeemed in order to obtain gold for export and for use in manufactures. The supply of gold in the Treasury is replenished largely by the purchase of bullion by the mints and assay offices. This bullion is paid for by checks, and gold certificates are issued against it only as needed to make disbursements. If Government disbursements were made wholly by checks on the Federal reserve banks it would not be necessary to issue gold certificates to replace those redeemed in coin and bullion. The coin and bullion could instead be deposited in the Reserve Banks, which could issue their notes against it. The ends, however, might be obtained if the United States continued to hold the coin and bullion and issued order gold certificates to the Reserve Banks instead, but under these circumstances the banks would not establish themselves so firmly as a necessary part of the United States fiscal system nor relieve the United States of the same expense.

THE GOVERNMENT'S PROBABLE REQUIREMENTS AND METHODS OF MEETING THEM

The Federal Reserve Banks can hardly expect the Secretary to designate them as fiscal agents and to deposit with them the entire

hundred and fifty to two hundred million dollars available for that purpose unless they can perform efficiently and economically (from the Government's standpoint) the functions now performed by the Treasurer and the Government depositaries. As a part of the expense of transferring the deposits to the Federal Reserve Banks must be reckoned the loss of more than a million dollars a year now collected as interest from depositary banks. Against this loss the promise of excess profits from the operation of Federal Reserve Banks will be a doubtful offset. The offset must be sought instead in the reduction of the expenses of the Treasurer's office and the sub-treasuries. The total cost of operating the Treasurer's office is about \$450,000 a year, excluding the amount reimbursed by National banks. The cost of operating the sub-treasuries is over \$650,000 a year. It is possible that the Federal Reserve Banks could save enough of this to nearly compensate the Government for the loss of the interest now collected on Government deposits. At the same time, however, the Reserve Banks must demonstrate their ability to perform the work as satisfactorily as it is now performed. To accomplish this it is believed that the following requirements must be met:

(1) The accounts must be centralized at Washington. This was done by the Treasury Department about two years ago and since the new plan has gotten into smooth operation it has proved so satisfactory that in our judgment it would not be wise to return to a decentralized system.

(2) Arrangements must be made that will insure the cashing of Government checks at par in all parts of the United States and the prompt transmission of such checks to Washington to be charged to the drawer's account.

(3) Arrangements must be made to accept Government deposits at every point in the United States where it is convenient for collecting officers to make them, and to report the receipts promptly to Washington for credit in the Government's account.

It is obvious that the Federal Reserve Banks can not themselves meet these requirements. They must utilize their member banks for the purpose and before the Board requests the Secretary to designate the Reserve Banks as fiscal Agents we suggest that it would be advisable to work out in detail a plan for accomplishing this. In this connection, the following suggestions are made:

(1) Deposits by Government officers in a member bank can be credited to the Federal Reserve Bank, or transmitted to the Federal Reserve Bank by draft or in cash. In any case it would be necessary

for the member bank or the Federal Reserve Bank to bear the expense of such transactions

Duplicates of the receipts issued to the depositors must be transmitted promptly to Washington by the receiving member bank for credit in the Government's account. To permit such credits to be delayed by coming through a Federal Reserve Bank would, it is believed, be unsatisfactory to the Treasury Department. The Federal Reserve Banks could later confirm the report of such deposits on receipt of advice from the bank accepting the deposit, or the Washington office might certify the deposits to the proper Federal Reserve Bank.

(2) Government checks paid by a member bank can best be charged to the proper Federal Reserve Bank to be credited by that bank to the member banks' reserve account.

The checks should be forwarded promptly to Washington to be charged to the drawer's accounts, a duplicate of the transit letter only going to the Federal Reserve Bank. On receipt of this duplicate letter the Federal Reserve Bank would charge the Government account, but such charges would be subject to verification from Washington. On proving the checks against the transit letters the Washington office would credit the Federal Reserve Bank and report to it the total payments by each member bank. Any other plan that we can think of would not merely delay the charges in the depositor's accounts but would add greatly to the aggregate amount of labor required for handling the Government's checks (which number about 25,000 a day).

In order to keep the depositors' accounts centralized at Washington, such accounts must either be left with the Treasurer and the Reserve Banks designated as depositaries to perform the same functions that National Bank depositaries now perform, or else the Reserve Banks must establish a central agency through which they can jointly keep the accounts of the Government deposits.

The adoption of the latter plan would take away from the Treasurer all of his work except that of redemption agent for paper currency. The office would then hardly deserve the title of Treasurer. It is unlikely, however, that Congress will abolish the office or alter the designation. Unwillingness to do so might result in opposition to the plans of the Federal Reserve Board to take over the work.

Two solutions of this difficulty suggest themselves.

(1) The Treasurer's duties may be changed to correspond with those of the Treasurer of a private corporation, that is, instead of being, as at present, the officer who holds the deposits of the United

States he may be made the officer who controls the deposits of the United States with the Federal Reserve System. This position is now occupied by the Assistant Secretary of the Treasury in charge of financial bureaus. He draws, or authorizes disbursing officers to draw, the checks by which substantially all government disbursements are made. This office might be combined with that of Treasurer. The incumbent of the combined office would control the deposits of the United States with the Federal Reserve System, with the mints and assay offices, and with such sub-treasuries as prove to be necessary to carry on the business of redeeming paper currency.

The second solution would be for the Treasurer to retain his present functions but to exercise them partly as Treasurer of the United States and partly as Treasurer of the Federal Reserve Board. In the latter capacity he might have charge of the Gold Settlement Fund, of the Government accounts, and of such other fiscal business of the Federal Reserve System as it proved desirable to transact through a central office. By this plan the organization and machinery in Washington need not be radically disturbed. The prime question would then become the proper division of the expenses of the Treasurer's office between the Federal Reserve System and the United States.

It is not clear that legal authority would be required to carry out either of these plans. The principal question that would arise in connection with the first plan is whether the Secretary can delegate to the Treasurer the duties imposed on him by law, which he now delegates to the Assistant Secretary in charge of finances. The principal question that would arise in connection with the second plan is whether the Treasurer of the United States can accept an appointment as Treasurer of the Federal Reserve Board and too, to some extent at least, the same clerks, the same vaults, etc., in his two capacities. The second plan would probably be the easier to carry out.

SUGGESTIONS

The changes discussed herein would be radical and far-reaching, and it would be difficult to have them made at one step. We believe that it would be wiser to request the Secretary of the Treasury to designate the Reserve Banks as Government depositories, at the same time discontinuing as many as possible of the present National bank depositories. The Reserve Board can then develop a system whereby the Reserve Banks through their member banks will receive deposits

and pay checks at any point in the United States. If such a system works satisfactorily there will be no need for any other depositaries than the Federal Reserve Banks except such Government offices as may be necessary to redeem and exchange paper currency.

If the Reserve Banks keep a joint account with the Treasurer through a central agency in Washington it will be obvious that they might as well keep instead the accounts of the various depositors and relieve the United States of that expense. The accounting work in the Treasurer's office would then become unnecessary.

If it were desired to go further, the next step would be to request the Secretary of the Treasury to supply the Federal Reserve Agents with reserve stocks of gold and silver certificates and United States notes, and take over the exchanges of United States paper currency as far as possible. The Federal Reserve Banks might also supply themselves with stocks of gold coin and bullion and redeem United States currency for member banks and through them for exporters, jewelers, etc. Such action if successfully carried out, would so reduce the work of the sub-treasuries that the question of discontinuing them would come up without any suggestion from the Board and the Reserve System would be left in practically the same relation to the United States Government that the National banks of the great European nations occupy to their Governments.

Very respectfully,

(Signed) HILBERT S. WOONS,
Acting Chief, Division of Efficiency

EXHIBIT "B"

MEMORANDUM FOR MR. DELANO, VICE GOVERNOR, FEDERAL RESERVE BOARD

In reply to your request for suggestions regarding the settlement of accounts between Federal reserve banks and the Treasurer of the United States through the gold settlement fund, I beg to state that the following are the only plans that occur to us for making such settlements without daily cash payments:

- (1) For the Treasurer to contribute to the gold settlement fund, that is, to maintain a deposit in gold with the Federal Reserve Board
- (2) For the Federal Reserve Board to deposit the whole or part of the gold settlement fund with the Treasurer
- (3) For the Treasurer to be represented in the gold settlement fund by a United States depositary (either a Federal reserve bank

or a member bank acting through its Federal reserve bank, that is, for the Treasurer to clear through a depository bank designated as his agent for the purpose

(4) For the Federal Reserve Board to deposit the whole or a part of the gold settlement fund with a United States depository bank (either a Federal reserve bank or a member bank)

Plan 1—For the Treasurer to make a deposit with the Federal Reserve Board There is no specific authority of law for the Treasurer to deposit Government moneys with the Federal Reserve Board. However, since the law authorizes the deposit of Government moneys with Federal reserve banks, it is probable that they can legally accept such deposits jointly through an agent designated for the purpose. This agent might be the same officer of the Federal Reserve Board who is charged with the custody of the gold settlement fund.

Plan 2—For the gold settlement fund to be deposited with the Treasurer There is apparently no authority of law for the Treasurer to receive deposits from the Federal Reserve Board or the Federal reserve banks, except deposits of public moneys and deposits to redeem Federal reserve notes. It is suggested, however, that the Treasurer might legally be appointed as the Treasurer of the Federal Reserve Board, and as such custodian of the gold settlement fund. In this capacity he might properly receive from the Treasury Department the same facilities in the way of vault room, etc., that have in the past been extended by the Department to the Federal Reserve Board and to the Federal reserve banks. It would be necessary for the Treasurer to make separate statements of the funds he held as Treasurer of the Federal Reserve Board and the funds that he held as the Treasurer of the United States. It would not be necessary, however, to keep the cash physically separated since but one kind of cash-gold would be held for the Board.

Plan 3—For the Treasurer to clear through a depository bank This plan would probably be unsatisfactory unless there was a branch Federal reserve bank in Washington that could represent the Treasurer directly in the gold settlement fund. Even then it would be less satisfactory than either the first or second plan.

Plan 4—For the gold settlement fund to be deposited with a United States depository If the deposit were made with a Washington bank (either a branch Federal reserve bank or a member bank) transfers between the Treasurer's account and the Board's account could easily be made. It is assumed, however, that the Board would

be unwilling to deposit any part of the gold settlement fund either with a Federal reserve bank or with a member bank

Whether it would be better for the Treasurer to make a gold deposit with the Federal Reserve Board or for the Board to maintain a gold deposit with the Treasurer depends on the policy adopted with reference to the Government's fiscal business. This matter is discussed in a separate memorandum

EXHIBIT "C"

MEMORANDUM FOR MR. DEAN

The following is a brief statement of the principal points in the memorandum submitted to you this morning relative to the designation of the Federal Reserve Banks as fiscal agents of the Government

The work of the Treasury that the Reserve banks might take over may be divided into three general classes

- (1) Receiving and holding Government deposits and cashing Government checks,
- (2) Keeping depositors' accounts,
- (3) Redecming and exchanging paper currency

(1) *Receiving and holding Government deposits and cashing Government checks*

The Secretary of the Treasury will doubtless be glad to designate the Federal Reserve Banks as United States depositories to receive and hold Government deposits and cash Government checks, and he will probably be willing to discontinue other national-bank depositories as soon as the Federal Reserve Banks demonstrate their ability to handle the business satisfactorily. To do this the Reserve Banks must make use of their member banks for receiving deposits and paying checks and it would be well for them to accept the Government's account jointly through a Washington agent

(2) *Keeping Depositors' Accounts*

Taking over depositors' accounts and receiving the Government's deposit through a Washington agent would result in transferring to the Federal Reserve System the greater part of the accounting work of the Treasurer's office. The simplest way to do this seems to be to adopt the Treasurer's office as it were, by designating the Treasurer as treasurer of the Federal Reserve Board

(3) Redeeming and Exchanging Paper Currency

Taking over the work of redeeming and exchanging United States currency, Federal Reserve notes, and national bank notes would result in the discontinuance of the sub-treasuries and the Treasurer's office as it is now constituted. The change could be most easily effected by the voluntary assumption of redemption and exchange work by the Reserve Banks.

APPENDIX C TO CHAPTER XLVIII

SUB-TREASURIES AND FEDERAL RESERVE BANKS

(From Federal Reserve Bulletin, February 1, 1917)

There is herewith reprinted the letter of the Secretary of the Treasury, dated December 16, 1916, transmitting a report relative to the United States sub-treasuries and their relation to the Federal Reserve Banks to the Speaker of the House of Representatives, as follows:

Sir: In the legislative, executive, and judicial appropriation act approved May 10, 1916, it is provided that—

"The Secretary of the Treasury is authorized and directed to report to Congress at the beginning of its next session which of the sub-treasuries, if any, should be continued after the end of the fiscal year 1917, and if, in his opinion, any should be continued, the reasons in full for such continuance, also if any or all of said sub-treasuries may be discontinued what legislation will be necessary in order to transfer their duties and functions to some other branch of the public service or to the Federal Reserve Banks."

In accordance with the above authorization and direction, I have the honor to report as follows:

There are nine sub-treasuries located, respectively, in the cities of Boston, Mass., New York City, N. Y., Philadelphia, Pa., Baltimore, Md., Cincinnati, Ohio, Chicago, Ill., St. Louis, Mo., New Orleans, La., and San Francisco, Cal. The sub-treasury system was authorized by the act of August 6, 1846, and subsequent acts amendatory thereof.

The duties and functions of the sub-treasuries may be stated generally as follows:

- Issue of gold order certificates on gold deposits
- Acceptance of gold coins for exchange
- Acceptance of standard silver dollars for exchange
- Acceptance of fractional silver for redemption
- Acceptance of minor coins for redemption
- Acceptance of United States notes for redemption
- Acceptance of Treasury notes for redemption

Acceptance of gold and silver certificates for redemption
 Cancellation (before shipment to Washington) of unfit currency
 Laundering of unfit currency which permits of this process
 Exchange of various kinds of money for other kinds that may be requested
 Remittances from United States depository banks of their surplus deposits of internal-revenue customs, money-order, postal, and similar funds
 Deposits of postal savings funds direct
 Deposits of money-order funds direct and indirect
 Deposits of post-office funds direct and indirect
 Deposits on account of 5 per cent redemption fund
 Deposits of interest on public deposits
 Deposits of funds belonging to disbursing officers
 Funds deposited for transfer to some other point through a payment in a sub-treasury located thereat
 Encashment of checks warrants, and drafts drawn against the Treasurer of the United States and presented at a sub-treasury for payment
 The payment of United States coupons and interest checks

In addition to the foregoing the sub-treasuries have the custody of a large part of the reserve and trust funds, consisting of the gold coin and bullion and silver dollars deposited to secure gold and silver certificates and greenbacks.

The receiving of deposits and payment of checks has been assumed to a large extent since the establishment of the Federal reserve system by the designation of Federal Reserve Banks as Government depositories in those sub-treasury cities where Federal Reserve Banks are located. Federal Reserve Banks are located in the sub-treasury cities of Boston New York Philadelphia, Chicago, St. Louis, and San Francisco. New Orleans has a branch of the Federal Reserve Bank of Atlanta while neither Baltimore nor Cincinnati has a Federal Reserve Bank.

It has always been deemed advisable to deposit the gold reserve and trust funds of the Government in several places rather than to concentrate them in one for reasons of security as well as public convenience.

The Federal Reserve Act does not expressly or by implication contemplate the substitution of the Federal Reserve Banks for the sub-treasuries, nor would it in my opinion be possible, or advisable if possible to attempt such a substitution. While the general or current fund of the Treasury may, in the discretion of the Secretary be deposited in the Federal Reserve Banks, the reserve and trust funds of the Government, viz, gold coin and bullion and silver dollars held in trust by the Government against outstanding gold and silver certificates and greenbacks, are not included in this authorization. The

gold coin and bullion held against gold certificates, amounting at present to more than \$2,000,000,000, a considerable part of which is deposited in the sub-treasuries, should not, in my opinion, be committed to the custody of any private corporations (and the Federal Reserve Banks are private corporations), but should be in the physical control of the Government itself. This applies with equal force to the \$152,979,025 of gold reserve held against United States notes and Treasury notes of 1890 and the silver dollars held against silver certificates. If, however, it should be deemed advisable to transfer the custody of these trust funds to Federal Reserve Banks or to any other private corporation or corporations, it would be necessary to make a special deposit of such funds in vaults especially constructed for the purpose and to maintain a Federal guard or some form of adequate Government control over such vaults.

Since the Federal Reserve Banks are, as I have already stated, private corporations, just as are the national banks, the duty of providing the necessary storage vaults and of assuming the custody and control of these trust funds could not be imposed upon the Federal Reserve Banks by legislation. It could only be accomplished by negotiation and agreement, involving, necessarily, compensation for the service performed. Whether or not arrangements could be made with Federal Reserve Banks or any private institutions for the custody of these trust funds upon terms and under conditions satisfactory to the Government and at a saving in cost over the sub-treasury methods, while, at the same time, providing all of the conveniences in handling these funds and the same measure of security as now afforded by the sub-treasury system, is a matter upon which I am unable to express an opinion. I desire to repeat, however, my earnest conviction that it would be unwise to commit the custody of these trust funds to any private institution or institutions. The custody of these trust funds, their maintenance, direction, control, and administration are distinctly a governmental function, and should be exercised only by the Government.

Aside from the custody of the trust funds of the Government, the sub-treasuries perform a highly useful service to the public in making exchanges of money, supplying money and coin where needed, and reducing the cost and expense of shipments of money and coin from a common center. It is necessary to maintain the facilities and conveniences provided by the sub-treasuries in the large centers of business in the country, such as the cities in which the sub-treasuries are

now located. Even if these particular functions could be transferred to Federal Reserve Banks where they exist the services rendered by the substituted agencies would have to be compensated for. This would involve expense to the Government while at the same time, the facilities provided might not be as thorough and satisfactory as those supplied by the sub-treasuries themselves.

It has been suggested that the sub-treasuries are merely conveniences and not necessities and that their duties might be performed entirely by the Treasury in Washington. This is in a sense true, but the cost of handling all the business from a common center, in a country so extensive as the United States, might be greater than the expense of the sub-treasury system, whereas the delays and inconveniences which the public would have to suffer might prove a very serious handicap upon business. It could with equal force be argued that internal revenue offices throughout the United States could be abolished and all of the work done at Washington, and, in like manner that many of the customs offices throughout the country could be abolished and all of the work done from Washington. It is the duty of the Government to provide adequate facilities to meet the convenience and necessities of the public in all parts of the country and the problem must be considered as a whole and not merely in detail.

It may be possible to reduce the expense of administration of some, or all of the sub-treasuries. It has been only one year since the Federal Reserve Banks were made Government depositories and fiscal agencies, and the current or general funds of the Government in such cities transferred to Federal Reserve Banks. About that time I appointed an improvement committee (described in my annual report of 1915) to make a careful study of departmental methods in all directions and to report upon the best means of improving the general administration of the Treasury service in its various important branches. The administration of the sub-treasuries is one of the subjects for investigation, and I sincerely hope that within another year it may be found possible to reduce the expense of operating these institutions in some if not in all of the cities where they are now located.

The amount of the Government funds in each sub-treasury, the volume of the total transactions annually performed by them, and the cost of maintaining these institutions are set forth in the following table.

1140 FEDERAL RESERVE SYSTEM IN OPERATION

Subtreasury	Government funds held June 30, 1916	Total transactions, fiscal year 1916	Expense of maintenance, fiscal year 1916
Baltimore	\$ 12,573,371 07	\$ 108,215,675 59	\$ 33,749 53
Boston	34,452,695 24	217,020,680 17	52,051 29
Chicago	120,537,589 79	597,365,033 95	84,325 04
Cincinnati	31,388,654 90	105,703,081 30	28,819 14
New Orleans	31,917,751 13	73,990,519 44	27,481 22
New York	329,402,485 45	2,464,715,492 12	187,587 75
Philadelphia	26,183,266 27	473,623,903 18	57,792 76
St Louis	48,629,847 19	193,370,692 54	37,385 63
San Francisco	99,088,010 01	291,058,033 53	25,812 27
Total	\$734,173,671 05	\$4,525,063,111 82	\$535,004 63

It will be seen that the cost of maintaining these institutions, treating the sub-treasury system as a whole, is only one one-hundredth of 1 per cent, approximately, on the total transactions involved—an insignificant sum compared with business done, the important service performed, and the conveniences afforded to the public. Aside from New York, the cost of maintaining the other eight sub-treasuries is \$347,416 88, which is a comparatively small sum to pay for the service and convenience they provide. If these institutions were abolished, the total cost of operating them would not be saved, as a counter expenditure by the office of the Treasurer in Washington, resulting from the increased work that would be thrown upon that office, would be entailed.

I am of the opinion that it would be inadvisable at this time to abolish all, or any, of the sub-treasuries. It is an important matter and should be considered deliberately. With the test of further experience it may develop that the functions of the sub-treasuries, or some of them, may be transferred to Washington, or to some other agency, but action should not be taken hastily or inadvisedly.

I regret exceedingly that my necessary absence from Washington, in connection with the establishment of the Federal farm loan banks and other public business, made it impossible for me to submit this report to the Congress at an earlier date.

Respectfully,

W G McAdoo, Secretary

APPENDIX D TO CHAPTER XLVIII

The following on the early war financing of the United States Government was published in the May, 1917 number of the Federal Reserve Bulletin

WAR FINANCING

War financing of record magnitude has been authorized for the United States during the latter part of April. Without a dissenting vote in either House of Congress authority has been given for the issue by the Secretary of the Treasury of \$7,000,000,000 in war bonds and shorter term certificates of indebtedness. The figures of this initial authorization dwarf the early war financing of European countries.

Anticipating an agreement by the two Houses of Congress over the details of the bill authorizing bonds and certificates of indebtedness to be issued the Secretary of the Treasury on April 20 announced that as soon as the bill became law he would sell \$200,000,000 of certificates of indebtedness to meet the requirements of the Treasury and the war situation pending the sale of Government bonds. In this connection it was stated that the offering of bonds would probably require about 60 days. After testing the sentiment as to the interest rate at which the certificates should be issued 3 per cent was determined upon and the amount increased to \$250,000,000. These certificates are payable on June 30. Subscriptions for this \$250,000,000 were obtained in a remarkably short time through the agency of the 12 Federal Reserve Banks.

POSITION OF OUTSTANDING BONDS

Federal Reserve Banks are holders of a considerable amount of 2 per cent United States consols and 3 per cent 30-year bonds and 1-year certificates of indebtedness. Consideration was given by the Federal Reserve Board to the position of these bonds in view of the proposed new issue at an interest rate of $3\frac{1}{2}$ per cent. Upon the question whether authority for the conversion of the above-named securities into $3\frac{1}{2}$ per cent bonds should be requested of Congress in an amendment to the war-bond legislation, the Federal Reserve Board sent out the following letter:

Telegrams have been received from a majority of the governors of the Federal Reserve Banks calling attention to the fact that the bill which recently passed the House authorizing the

United States to issue and sell $3\frac{1}{2}$ per cent bonds, contains no provision for the conversion of the 3 per cent bonds held by the several Federal Reserve Banks

The Board has already given consideration to this matter, realizing that the issuance of \$5,000,000,000 worth of $3\frac{1}{2}$ per cent bonds would naturally have a tendency to depreciate the market value of the 3 per cent bonds held by the Federal Reserve Banks. The amount now held by such banks, namely, about \$7,000,000, is, however, relatively small and the Board is undecided whether it would be justified at this time in asking for an amendment to section 18 authorizing the conversion of the 3 per cent bonds now held and the 2 per cent bonds subsequently acquired by the Federal Reserve Banks into bonds paying a higher rate of interest. The Board no doubt will ultimately ask for such an amendment.

From the best information obtainable it is unlikely that Congress will at this session pass any legislation except that coming within the classification of war measures. It is fully understood that unless such an amendment is obtained Federal Reserve Banks will not be disposed to purchase 2 per cent bonds and to offer them for conversion into 3 per cent bonds and notes, and the Board would not require such purchase if the 3 per cent bonds are below par and a conversion could not be made without a loss to the Federal Reserve Banks.

Before determining whether an effort should be made at this time to obtain the desired amendment, or whether this action should be deferred until Congress reconvenes in December, the Board will be glad to have the views of the governors on the following questions:

(1) Will the probable demands for currency during the period of the war make it advisable to discourage curtailment of national-bank-note circulation by discontinuing all conversion of 2 per cent bonds having the circulating privilege for bonds or notes without the circulating privilege? In other words, is it probable that Federal Reserve notes can be issued in sufficient volume to take care of current needs, or will it probably be necessary for Federal Reserve Banks to use any 2 per cent bonds acquired as a basis of issue for Federal Reserve Bank notes in order to supplement circulation outstanding?

(2) Assuming that there will be no redundancy of circulation if retirement of national-bank notes is not encouraged, would it not be advisable to defer any effort to obtain an amendment to section 18, which might have a tendency to encourage the conversion of bonds having the circulating privilege for bonds without this privilege?

The Secretary of the Treasury has made no announcement of his position in this matter.

FIRST OFFERING OF CERTIFICATES

Below is given the announcement of the Secretary of the Treasury, given to the press on April 20, stating his purpose to make the first

offering of certificates of indebtedness under the war loan act of \$200,000,000

Secretary McAdoo stated to-day that as soon as the war loan bill becomes a law he intends to sell such amounts of Treasury certificates of indebtedness as may be necessary to meet the requirements of the Treasury and the war situation pending the sale of Government bonds.

It will probably require about 60 days to make a public offering of bonds. Meanwhile certificates of indebtedness maturing June 30, and receivable with accrued interest, in payment of subscriptions for bonds, will be sold. The Secretary appreciates the desirability of avoiding any derangement of the money market, and in the financial operations in which the Government is about to engage it will be his purpose to adjust receipts and disbursements in such a way that as far as possible money paid in will be promptly returned to the market. The contemplated sale of Treasury certificates is in line with this policy. Should the banks during the next few weeks absorb several hundred million dollars of these certificates, the proceeds being paid out in the course of business, the banks will possess ready means with which to meet withdrawals made later by depositors in paying for bond subscriptions. The result of this method will be a gradual anticipation or payment on account of bonds with a steady and continuous return to the banks of the moneys paid in.

The Secretary sounded the market yesterday with respect to temporary borrowings and met with a very satisfactory response on the part of important banks and bankers in financial centers, especially in New York City. The Secretary was assured that reasonable immediate requirements could be met by a sale of certificates bearing as low a rate as $2\frac{1}{2}$ per cent interest but that there would be no doubt about the sale of the largest amount of such debt certificates and that a wide market for the same could be created if they were offered at 3 per cent interest.

The Secretary feels that in order to carry out the policy above outlined, temporary borrowing ought to be done on a basis that will enable banks generally throughout the country—State banks and trust companies as well as member banks of the Federal Reserve System—to have a thoroughly liquid asset in their vaults and at the same time to be able to avail themselves of the opportunity of preparing for the large bond issue. Therefore, as soon as the war loan bill becomes a law the Secretary proposes to authorize Federal Reserve Banks to receive applications for Treasury certificates of indebtedness payable June 30 next, and bearing interest at the rate of 3 per cent per annum. The first offering of such certificates will probably be \$200,000,000.

DUTY OF RESERVE BANKS

On the day the above statement was issued Governor Harding sent to Federal Reserve Banks the following letter:

Your attention is directed to a statement issued to the press this afternoon by the Secretary of the Treasury. In view of the large issues of United States bonds which will be offered in the

near future and which it is hoped will be subscribed for to a great extent by investors, large and small, whose funds are now on deposit in banks, the Board regards an investment by banks in United States Treasury certificates of indebtedness having a short maturity and which are receivable in payment of subscriptions to United States bonds, as a highly desirable investment for them. The Secretary of the Treasury has announced his intention, in the financial operations in which the Government is about to engage, to adjust receipts and disbursements in such way that as far as possible money paid in will be promptly returned to the market and the Federal Reserve Banks may be counted upon by offering liberal terms of rediscounting to do their utmost in counteracting any effect of temporary dislocation of banking funds. The banks of the country by absorbing these certificates in advance of the issue of the war loans, will possess themselves of ready means with which to meet withdrawals made by depositors for the purpose of paying for bond subscriptions and they will thereby assist in an effective manner in paving the way for the successful flotation of our war loans.

The Board does not doubt that you will impress upon the banks of your district, both national and State, the importance of this offer, and that you will enlist their hearty cooperation in this plan of preparing the field and preparing themselves.

This press statement was issued on April 21

The Federal Reserve Board to-day telegraphed all Federal Reserve Banks that payments for the new issue of certificates of indebtedness under the war financing act, subscriptions for which have been taken by Federal Reserve Banks, will probably be called for by the Secretary of the Treasury April 25 or 26. Remittances will be made by subscribers to the Federal Reserve Banks of their districts and placed to the credit of the Treasurer of the United States.

EXISTING INDEBTEDNESS

The Treasury Statement of March 31, 1917, showed the interest-bearing debt of the United States to be \$1,023,357,250. This included the \$50,000,000 in certificates of indebtedness issued as of April 1, but does not include the \$200,000,000, announcement of the intention to issue which was made on April 20.

There is authority under legislation existing prior to the passage of the war financing law for the issue of \$495,569,000 in bonds and \$320,000,000 in certificates of indebtedness. This does not include the authorization to issue bonds or notes to maintain the gold reserve or for the issue of postal savings bonds.

Below is given a table showing the authorization, rate, and amounts of the bonds and certificates of indebtedness which make up the present interest-bearing debt of the United States.

INTEREST-BEARING DEBT PAYABLE ON OR AFTER SPECIFIED FUTURE DATES

[Treasury statement of Mar 31, 1917]

Title of debt	Authorization	Rate	When issued	When redemption or payment	Amount issued	Outstanding Mar 31, 1917
Consols of 1910	Mar 14 1900	2 per cent	1900	Payable after Aug 1, 1910	\$1,030,150	\$1,030,150
Loan of 1908 1918	June 13 1908	3 per cent	1908	Redeemable after Aug 1, 1918	\$1,030,702,660	\$1,030,702,660
Loan of 1915	Jan 14 1915	4 per cent	1915	Payable after Jan 1, 1915	1,162,315,400	1,162,315,400
Postal savings bonds Series 1906	June 28 1906, Dec 21 1905	2 per cent	1906	Redeemable after Aug 1, 1916	\$1,454,631,960	\$1,454,631,960
Series 1908	Aug 5 1909, Feb 4 1910, Mar 2 1911	do	1908	Redeemable after Nov 1, 1918	\$1,030,000,000	\$1,030,000,000
Series 1911	Dec 23 1913	3 per cent	1911	Payable after Jan 1, 1911	50,000,000	50,000,000
Conversion bonds		do	1916-17	Payable 30 years from date of issue	25,057,200	25,057,200
One-year Treasury bills	do	do	1916-17	Payable 1 year from date of issue	23,510,000	23,510,000
Certificate of indebtedness	Mar 3 1917	2 per cent	1917	Payable June 30 1917	50,000,000	50,000,000
Postal savings bonds (first to fifth series)	June 25 1910	2 per cent	1910	Redeemable after Jan 1, 1918	9,151,800	9,151,800
Postal savings bonds 1917-1937 (sixth series)	do	2 per cent	1917	Redeemable after Jan 1, 1937	887,960	887,960
Aggregate of interest-bearing debt					\$1,250,627,150	\$1,250,627,150

* Of this amount \$21,663,900 have been converted into conversion bonds, and \$1,969,000 into one year Treasury notes.

** Of this original amount issued \$13,419,000 have been refunded into the conversion bonds of 1930, and \$2,396,800 have been purchased for the sinking fund and canceled.

† Of this original amount issued \$48,253,500 have been purchased for the sinking fund and canceled.

‡ Of this original amount issued \$1,816,500 have been converted into conversion bonds and \$2,928,000 into one year Treasury notes.

§ Of this original amount issued \$1,904,400 have been converted into conversion bonds and \$1,917,000 into one year Treasury notes.

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There is presented below a list of the existing legislation, exclusive of the War Loan Act, under which the Government of the United States may issue bonds and certificates

	Rate	Amount authorized	Issued
1 Panama Canal bonds, act Aug 5, 1909	<i>P a</i> 3	\$295,569,000	\$50,000,000
2 Panama Canal bonds, issue for nitrate plant, act of June 3, 1916	3	*20,000,000	None
3 Panama Canal bonds, issue for merchant marine, act of Aug 5, 1909	3	*50,000,000	None
4 For extraordinary expenditures, revenue act Mar 3, 1917 (Mexican expenditures, armor-plate plant, Alaskan railway, purchase of Danish West Indies, etc)	3	100,000,000	None
5 Expediting naval construction, act of Mar 3, 1917	3	150,000,000	None
6 Certificates of indebtedness, act of Mar 3, 1917	3	300,000,000	50,000,000
7 Certificates of indebtedness, act June 25, 1910	3	20,000,000	

* Included in 1
Legislation authorizing the issue of bonds or notes to maintain the gold reserve and parity, and for issue of postal savings bonds, is not included in the above list

SUBSCRIPTIONS IN 1898

For subscriptions to the \$200,000,000 war bond issue of 1898, 31 days were allowed. In this period the Treasury Department received subscriptions numbering 320,226 for \$1,500,000,000. It is interesting, in view of the authorized issue of war bonds, of which it is anticipated that individuals will take a good part, to note the number of subscribers for small amounts to the loan of 1898, as shown by the table given below

Subscriptions	
For less than \$100	11,483
\$100 to \$180	14,974
\$200 to \$280	9,902
\$300 to \$380	7,594
\$400 to \$480	7,698
\$500 only	180,573
\$520 to \$980	11,862
\$1,000 to \$1,980	25,152
\$2,000 to \$2,980	10,349
\$3,000 to \$3,980	5,165

\$4,000 to \$1,400	5,223
\$1,500 only	1,875
More than \$4,500	28,376
Total	<u>320,226</u>

Individual purchases of the loan of 1898 were not confined to any section of the country. The subscriptions for \$500 or less numbered 232,224. These were accompanied by full payment, the total of subscriptions of \$500 or less being \$100,444,560.

Every opportunity was given for subscription to this issue by individuals. Newspapers were supplied with information relative to the bonds and with few exceptions their aid was given without charge. In addition, circulars and forms for subscription were supplied to the 22,000 money order post offices, to express offices, and to banks.

Small subscribers were given the preference, and those who had asked for as much as \$4,500 received only a prorated award, on a basis of \$1,300 each. The bonds were dated August 1, 1898, and delivery to smaller subscribers was completed about September 1. Delivery to the larger subscribers continued for some time after that date, receipts of the proceeds for this loan extending to April 1, 1899, although the bulk of subscriptions was fully paid within the first four months. Of the total amount nearly \$125,000,000 was remitted by means of checks on banks in all parts of the country. Of the remainder, paid in cash into the offices of the Treasury more than one-third was in tenders of gold although no preference for one kind of money over another was made.

The bonds bore interest at 3 per cent and to the time of their issue the Government had never put out bonds payable by their terms, either principal or interest, in gold coin or in silver coin. None of the civil war bonds except certificates of temporary loan and the notes of 1864 and 1865 which were payable in lawful money, contained any statement as to the kind of money in which they should be paid. The bonds of 1898 are redeemable after August 1, 1908, and payable August 1, 1918.

The first bonds payable specifically in United States gold coin were the 2 per cent consols of 1930, the act providing for which was approved by the President on March 14, 1900. The amount of this issue was \$646,250,150. Of this issue there have been converted by Federal Reserve Banks \$24,648,100 into 3 per cent 30-year conversion bonds, and \$21,878,000 into 3 per cent one-year Treasury

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notes A considerable part of these converted bonds and notes has been sold. The bonds thus converted were purchased by Federal Reserve Banks either in the open market or through offerings made by member banks of the system through the Treasurer of the United States under section 18 of the act. The total of 2 per cent consols thus retired is \$46,526,100.

BOND HOLDING OF FEDERAL RESERVE BANKS

The United States bond holding of Federal Reserve Banks on March 31, 1917, was as follows:

Amount of United States bonds, certificates of indebtedness and notes without circulation privilege

3 per cent of 1961	\$ 900
3 per cent conversion	3,634,300
3 per cent 1-year notes	20,567,600
2 per cent certificates of indebtedness	*48,000,000
Total	<u>\$ 72,202,200</u>

Amounts of United States bonds with circulation privilege

2 per cent	\$ 20,049,910
3 per cent	7,491,740
4 per cent	5,168,450
Total	<u>\$ 32,710,100</u>
Grand total	<u>\$104,912,300</u>

* \$2,000,000 of United States certificates of indebtedness entered on books Apr 2, 1917

CHAPTER XLIX

EARLY WAR POLICIES

Financial Aspects of War

Secretary McAdoo's first effort to obtain funds from the reserve banks had thus been successful. There was a temptation to continue the same easy method of getting money, but representations were immediately made to the head of the Treasury for the purpose of convincing him of the disastrous character of the existing plan. While probably not very much in sympathy with the academic or purely financial argument that was thus directed to him, Mr. McAdoo recognized at least the necessity of avoiding any direct break with the reserve banks or with the financial community. It had not taken him or the government long to realize that in entering the war they had committed themselves to an enormous financial program, the like of which they had hardly imagined. Within a few weeks after the declaration of war the United States was visited by a delegation of almost every belligerent country, whose members declared themselves absolutely without funds and insisted that their governments were at the end of their resources to extend war plans. Some of them, it was well understood, did not hesitate to go so far as to threaten to make peace with Germany unless they obtained the funds they wanted from the United States, thus leaving the latter to cope as best it might with a foreign foe in a war for which it had made no preparation, had no army, and only an incompletely equipped and manned navy. It was obviously not the part of wisdom to turn a deaf ear to these delegations even if the United States had been better equipped for war than it actually was. As

things stood, it would have been almost suicidal to refuse the aid, of which some of them at least were so urgently in need.

Consequently, within thirty days after the declaration of war, many had begun to think that our fighting would be done largely in Wall Street and in Washington, and would consist in raising and transmitting dollars or in shipping goods. True, even at this early date some whisperings of the necessity of sending perhaps 25,000 men to Europe had been heard at the Treasury and State Departments, but they were only tentative. It was impressed upon the Federal Reserve Board and upon the reserve system from the beginning, that what was wanted was money and that we were well organized to supply it. By supplying it, it was to be inferred, we should enable others to fight our battles, at least in large part, so that the most immediate and urgent thing of the moment was that of raising funds in unprecedented quantity. Yet, against the raising of such funds by ordinary banking or fiat money methods the authorities of the reserve system set their faces, while others recognized, at least abstractly, the justice of the argument. Accordingly, consideration began to be given in most earnest fashion to the imposition of taxation upon a large scale, but work in this direction had not gone far when it was realized that to get a satisfactory measure passed and later directly applied and yielding tangible funds, would be a labor of many months. Accordingly, at least for the moment, the financial authorities of the government were driven back upon the necessity of borrowing, and of borrowing enormously.

Consulting the Bankers

In this emergency it was obviously of little or no use to employ the old-fashioned methods, hallowed by time, of announcing the issue of bonds to be taken by banks or by individuals, and of awaiting bids and taking what came along. Quite as obviously was it impossible to expect to sell the bonds by exhortation or by traveling agents, as had been done with

success during the Civil War. A study of the methods to which Great Britain had already been driven showed that the problem was one of mass-financing as against individual advances, and that success would be attained only by organizing the entire financial forces of the community into a compact body whose efforts should be united and directed toward getting the maximum amount of funds that could be obtained.

Just how much the Treasury needed at the time was far from certain. An early computation of the needs of the various countries and a comparison with our own necessities appeared to indicate that for the remainder of the year 1917 a sum of from four to six billion dollars would be needed. The amount fairly staggered the imagination of Americans, who had been thinking previously in hundreds of millions when considering government financing. Secretary McAdoo eventually fell back upon the idea of ascertaining from the banking community the largest amount which in their judgment could be raised at all, and then of floating a loan for that amount. The question was put before the Federal Reserve Board and in its opinion was emphatically one in which the services of the Advisory Council might well be enlisted. Accordingly, at the spring meeting of that body, the whole question was taken up with the members, who, as will be remembered, were representative bankers drawn from all parts of the United States. At a joint meeting held in the board room between the Advisory Council, the Board and the Treasury officials, including Secretary McAdoo, the definite question was proposed: How much could possibly be raised by any and every means in a single loan? Replies varied from five hundred millions up to about a possible one billion, five hundred millions. Beyond the latter figure there was none who dared to go, save for tentative and vague suggestions that perhaps a larger sum might be obtained by the use of extreme methods. While the Board never definitely committed itself on the subject, it was apparently in general sympathy with the view of the Advisory

Council, although recognizing that the fixing of the limit was essentially a matter to be attended to by the Secretary of the Treasury and his aides, so that it made no effort to influence him, even had it been able, but awaited instructions. These came in the form of an announcement that the First Liberty Loan would be fixed at two billion dollars and that subscriptions over and above that sum would be returned to those making them.

Question of Taxation

Secretary McAdoo had probably been from the beginning more or less adverse to tax exemption for the new bonds, although it is not known that he ever committed himself in very positive language in one way or the other. At the early meeting of the bankers, to which reference has just been made, he, however, fully discussed the value of tax exemption, suggesting the thought that such exemption was probably worth from 1 to $1\frac{1}{2}$ per cent, i.e., a tax-exempt bond whose interest was $3\frac{1}{2}$ per cent would sell competitively with ordinary commercial bonds bearing 5 per cent on the basis of the tax legislation which Congress had adopted or was planning. While the bankers were inclined to regard this estimate as high, there was little disposition to quarrel with the Secretary's figures, which presumably had been made upon an actuarial basis and with intimate knowledge of conditions which the bankers could not be expected to have. The bankers themselves were largely adverse to tax exemption, believing it to be an undesirable kind of financing. Their answers in regard to the amount of bonds which could be floated were apparently based upon the theory that the new issue would be, at most, only partially tax-exempt. It is probable, when Secretary McAdoo raised the amount of the loan \$500,000,000 above the ultimate amounts that had been named by the most daring of bankers, he reconciled himself to the notion of complete tax exemption in order that the loan might be definitely floated and might take precedence

over all other securities as a pioneer form of investment to be offered to the public at large. Accordingly, the First Liberty Loan was definitely conceived of and placed upon the market as a tax-exempt issue, free of all taxes, both normal and super-tax, national and state. It was to be a supreme test of the credit-obtaining power of the government and this was definitely made known to the Federal Reserve Board and to the reserve banks.

Making the Loan Sell

Even with the tax exemption which had been made a basic feature of the new loan, there was the greatest of doubt in the minds of almost all government financiers whether the loan would sell to anything like the sum which it had been determined to issue. No such enormous government loan had by us been attempted before. No such war had ever been shared in by the American people, and it could be doubted whether the war hysteria and war anxiety of former struggles had ever exceeded the display of those qualities at the time of our entry into the European contest. There is always a tendency to regard the present emergency as greater than any in the past, but aside from any such tendency to exaggeration, the fact remained that few if any careful thinkers doubted the immensity of the responsibility which we had taken upon ourselves. In some ways this state of mind might be regarded as helping the sale of the bonds; in other ways as retarding it. It was impossible at the outset to form any valuable estimate of the drift of public sentiment or public temper. The Treasury Department was, therefore, naturally and properly desirous of making the loan sell and of aiding this process by every means in its power.

The urgency of the case was accordingly brought to the attention of the Federal Reserve Board, with the recommendation that the Board should take all measures that were necessary to adjust the discount rate of the reserve banks to the coupon

rate of the new bonds. Disregarding the tax exemption features of the loan which at once commended it to those who foresaw heavy taxation by Congress which they desired to forestall, it was undoubtedly the opinion of Treasury financiers that a very large proportion of the loan would have to be financed through the banks. Hence the desire to encourage borrowers to believe that they could carry the loan without material expense, and hence a demand for the Federal Reserve Board to adjust its rate to the coupon rate of the bonds. The Board was unquestionably reluctant to take any such step. It knew perfectly well that the rate on the bonds had been artificially lowered by the tax situation and that even without this it necessarily represented a figure distinctly under the general level of normal commercial credit. By establishing a rate of rediscount which was below the normal rate likely to prevail in the market, the Board practically put the reserve banks in the position of bidding for the entire surplus of the loan over and above what would be easily absorbed. A terrible responsibility would be involved in a policy of this kind, and it is to the credit of the Federal Reserve Board that its action was taken with so much reluctance and hesitation.

The subject came up for sharp discussion very soon after the announcement of the loan in June, 1917, and the arguments for and against were freely considered. There was ample recognition on the part of the members of exactly what they were doing. The psychological attitude, however, of the members was such as to make any kind of historical or abstract discussion practically without weight. At the final meeting, after the pros and cons of the proposed policy had been debated for hours, one member ended the discussion by merely asking how the Board would be able to face the community if it should put technical banking considerations ahead of patriotic feeling and sentiment. This kind of argument happily did not appeal very strongly to the majority of the members, but they were faced with the facts, namely, that the Treasury

Department was in position to override the Board, and had it chosen to do so could with the assistance of the reserve banks themselves undoubtedly attain that object. Indeed, there was broad suggestion in various unofficial or semiofficial quarters that the Treasury would do whatever was necessary to make the loan a success and that mere sticklers for banking abstractions need expect no consideration. In these circumstances prudence and the practicalities of the case dictated an acceptance of the Treasury policy and the Board almost inevitably felt itself driven to the making of a rate which should be substantially identical with the coupon rate on the bonds. This rate was fixed at $3\frac{1}{2}$ per cent on June 15.

Enlisting the Banking Community

It was also perceived that the activities of the banks actually in the federal reserve system, numbering as they did a good deal less than one-third of the total number of banks in the country, would not be sufficient to reach the entire borrowing or bond-buying community. The reserve banks, numbering twelve, could not, even with the aid of their limited number of branches, reach the entire financial community of the country, unless they could work through some effective medium. Careful study of the Reserve Act disclosed that provision had been made whereby the Board was at least permissively authorized to give to member banks the power to discount on behalf of other non-member banks acting as agents for the latter. With this as a basis it was announced that notes of non-member banks collateralized by government bonds and presented through a member, would be discounted at reserve banks. Thus in effect all banks, whether members or non-members, were given the power to discount with reserve banks paper which had been made for the purpose of buying Liberty bonds of the first issue, and the entire banking community of the country was compelled to aid in the endeavor to obtain a means of reaching every individual throughout the land who might have the necessary

cash to furnish a margin for the purchase of the securities. All in all, the way was thus made clear for a positive appeal to an absolutely nationwide community of possible buyers.

The Loan a Success

Looking back upon the experiment now, it is easy to see that the first loan would have been a success even without these extreme measures. The amount of fluid capital then available as a result of war profits and general prosperity throughout the country was enormous. The appeal made by the tax-exemption feature of the bonds was very powerful. War patriotism and hysteria was at a high point. The banks generally were in fair condition and disposed to help without very much regard to costs. In these circumstances, the first loan would probably have gone off successfully even if the reserve banks had not supported it as they did. Their support in the background meant that it was assured success from the beginning, but even without such assurance many buyers would not have hesitated but would have purchased heavily either with or without the aid of their banks, and either at or above the coupon rate indifferently. As a matter of fact, government officers, including the Federal Reserve Board, were surprised at the relatively light demand made upon the resources of the reserve banks by this tremendous operation. What the exact change wrought as a result of it may be understood by comparing the situation of the system shortly before and shortly after the completion of the loan¹. This has been done in the table shown.

What this meant can be comparatively easily summed up. It implied that the "slack" of credit in the member banks was so great throughout the country that they were able to handle the loan without much reliance upon the reserve banks. It also probably meant that the investors of the country did not have to go to the commercial banks in any excessive degree. Taken

¹ First instalment was 2 per cent plus 18 per cent due June 28. Thus the bank statement of June 29 was the last not to show effects of the loan.

RESOURCES AND LIABILITIES OF THE FEDERAL RESERVE SYSTEM

At Close of Business on Friday, June 20 to July 20, 1917

RESOURCES

(000 \$ omitted)

	June 29	July 6	July 13	July 20
Gold coin and certificates in circulation	\$ 284,264	\$ 170,350	\$ 171,417	\$ 188,119
Gold certificate in circulation	345,915	371,380	368,353	403,821
Gold with foreign agencies	52,362	52,501	52,501	52,500
Gold with Federal Reserve agent	102,603	113,115	128,333	123,859
Gold redemption fund	9,102	9,448	12,647	11,601
Legal tender notes in circulation	39,810	48,524	47,515	50,301
Total reserve	1,311,406	1,356,017	1,400,016	1,410,321
Bills discounted—members	197,242	20,853	1,016,3	161,380
Bills brought in open market	202,270	201,664	194,047	191,755
United States government securities	36,426	12,025	43,901	12,265
United States government short-term securities	34,302	24,659	30,359	3,050
Municipal warrants	2,446	2,142	2,111	2,186
Disfavored Federal Reserve banks—net	*1,418	*19,505	*7,005	*1,112
Uncollected items	221,005	251,334	253,722	242,967
Five per cent redemption fund against Federal Reserve bank notes	500	500	500	500
All other resources	700	851	786	1,611
Total resources	2,053,394	2,033,760	2,074,790	2,116,124

LIABILITIES

	June 29	July 6	July 13	July 20
Capital paid in	\$ 57,176	\$ 57,657	\$ 57,681	\$ 57,733
Government deposits	300,966	113,626	300,872	184,631
Due to members—reserve account	1,033,190	1,112,317	1,079,672	1,164,995
Due to non-member banks—clearing account		5,000	6,847	4,797
Collection items	140,527	161,588	153,363	105,284
Federal Reserve notes in actual circulation	508,807	527,459	532,508	534,226
Federal Reserve bank notes in circulation—net liability	934	1,173	1,060	2,306
All other liabilities including foreign government credits	2,524	21,908	1,887	2,192
Total liabilities	\$2,053,394	\$2,033,760	\$2,074,790	\$2,116,124

* Difference between net amounts due from and net amounts due to other Federal Reserve banks

together, only a moderate draft upon the bank credit was made, or, in other words, the loan was definitely placed. This fact, soon perceived and widely announced, together with the news that oversubscription had occurred and that the Secretary of the Treasury had returned some of the funds to subscribers, gave a tremendous impression of financial strength. In itself this alone was a great achievement, as it showed what the nation could do at a pinch. It also undoubtedly enhanced in the mind of the Treasury Department the notion that the federal reserve system could be used as an important factor for the purpose of sustaining very much greater loans, and that there was, indeed, hardly any limit to the possibilities of borrowing. This thought, perhaps, tended to make our financial policy more reckless during the autumn of 1917. Certain it is that very great financial recklessness was exhibited, expenditures being, as all now are agreed, largely in excess of the real requirements of the situation.

The months immediately after the placing of the first Liberty Loan thus constitute the period of financial transition which marked great changes both in public finance and in the theory and policy of our banking system. The following discussion of conditions was prepared¹ at the time, and reviews the situation as it then stood, at a critical moment.

THE BANKS AND THE LIBERTY LOAN

Banking developments during the month of July have given the first clear indication of the country's ability to purchase and hold the new issues of Government bonds that were being placed on the market. There were no definite indications so long as the process of subscription continued, and no accurate figures for some time after the closing of subscriptions, establishing how far the loan had been paid in full by subscriptions and how far the banks of the country had availed themselves of the special discount privileges afforded by the Federal Reserve System both to member and nonmember institutions. The first payment made upon subscriptions was 2 per cent of the face of the bonds plus 18 per cent additional payable on June 28,

¹ By the author, Federal Reserve Bulletin, Aug., 1917, p. 577

leaving 80 per cent of the face to be provided for by subsequent payments. Figures setting forth the loan situation at Federal Reserve Banks published in advance of the announcement of the result of the loan were somewhat misleading because of the fact that not a few institutions had discounted heavily at Federal Reserve Banks in order to be ready to make payment in full for bonds subscribed to by them. Such discounting suggested the possibility of a continuous drain upon the resources of the reserve banks. Reductions of the larger subscriptions and prompter payment by smaller subscribers than had been looked for resulted in the almost immediate reduction of accommodation furnished by Federal Reserve Banks to their members and through the latter to nonmembers. The outcome has been to make the demands upon the Federal Reserve Banks in connection with the loan decidedly smaller than had at one time seemed probable. The peak of the loan borne by reserve banks was reached on June 22 immediately after the completion of the subscriptions at which time the aggregate bills held by the Federal Reserve Banks amounted to \$435,000,000 as contrasted with \$145,000,000 about a month earlier. Almost immediately for the reasons already indicated this large volume of paper began to be lowered falling on July 13 to \$335,000,000. Of this latter sum only \$13,159,000 represented paper secured by United States bonds or certificates. A third payment of 20 per cent due on July 30 is in process of being made as this issue goes to press, but arrangements to liquidate it having already largely been made by the subscribers and the amount involved not being likely to be much in excess of \$100,000,000 the payment will probably not materially affect the banking position.

OPERATIONS OF RESERVE BANKS

Considerable liquidation of investments principally of bills and United States securities, is indicated by the comparative statement of the earning assets held by the Federal Reserve Banks on June 22 and July 20, respectively. Liquidation apparently set in immediately following the completion of subscriptions to the Liberty loan and is shown to have been heaviest at the New York bank, which reported the largest amount of accommodation to member banks in connection with Liberty Loan operations. Substantial reductions in the amounts of bills on hand are also reported by the three eastern reserve banks and by the San Francisco bank. Most of the bills liquidated were member banks collateral notes secured by commercial paper or United States securities. Between June 22 and July 13 the amount of such

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notes held by Federal Reserve Banks decreased from \$169,789,000 to \$59,557,000, since then the total has increased to 78,795,000. the amount held on July 20

It is noticeable that the Federal Reserve Banks' holdings of acceptances increased between June 22 and July 20 from \$194,303,000 to \$197,720,000 as against a simultaneous decline in the holdings of discounted bills from \$240,984,000 to \$161,386,000

In the following table are given the changes between the two dates in the amounts of bills held by each Federal Reserve Bank, also changes in the total holdings of other classes of investments

Federal Reserve Bank	June 22	July 20	Net increase	Net decrease
Boston	\$ 41,795,000	\$ 34,926,000		\$ 6,869,000
New York	220,032,000	133,554,000		86,478,000
Philadelphia	27,586,000	24,642,000		2,944,000
Cleveland	20,499,000	17,686,000		2,813,000
Richmond	16,919,000	18,663,000	\$1,744,000	
Atlanta	5,227,000	6,559,000	1,332,000	
Chicago	41,933,000	50,535,000	8,602,000	
St Louis	11,267,000	15,013,000	3,746,000	
Minneapolis	10,586,000	10,648,000	62,000	
Kansas City	18,031,000	24,061,000	6,030,000	
Dallas	5,151,000	7,925,000	2,774,000	
San Francisco	16,261,000	14,899,000		1,362,000
Total bills	\$435,287,000	\$359,111,000		\$ 76,176,000
Total United States securities	114,918,000	75,315,000		39,603,000
Total municipal warrants	2,444,000	2,186,000		258,000
Total investments held	\$552,649,000	\$436,612,000		\$116,037,000

DISTRIBUTION OF BONDS

These facts suggest in outline the satisfactory character of the outcome of the Liberty Loan operation from the standpoint of the Federal Reserve Banks. The resources of the banks have been employed as required, but have not been made a regular reliance. They are available for occasions of future need. There remains to be answered, however, the question how far the banks of the country have become investors in Government bonds and also how far the "ultimate investor" has been obliged to rely upon his bank for assistance either in taking or carrying the new securities.

PAYMENTS ON LIBERTY LOAN ALLOTMENTS BY THE FEDERAL RESERVE BANKS
TO JUNE 30, 1917

Federal Reserve Bank	Allotment	Paid in United States Treasury certificates (approximate amounts)	In cash (ap- proximate amounts)
Boston	\$ 265,478,000	\$ 45,800,000	\$ 63,800,000
New York	593,987,000	275,500,000	151,500,000
Philadelphia	164,760,000	39,400,000	30,000,000
Cleveland	201,977,000	48,000,000	69,900,000
Richmond	88,594,000	10,000,000	19,300,000
Atlanta	46,283,000	4,100,000	10,400,000
Chicago	272,702,000	52,100,000	64,800,000
St. Louis	65,029,000	22,900,000	17,100,000
Minneapolis	53,759,000	4,800,000	20,600,000
Kansas City	62,183,000	19,600,000	17,200,000
Dallas	36,663,000	10,500,000	10,000,000
San Francisco	149,045,000	21,800,000	43,700,000
Total	\$2,000,000,000	\$554,500,000	\$518,300,000

Federal Reserve Bank	By credit (ap- proximate amounts)	Total payments to June 30	Ratio of pay- ments to allot- ments	Payments still due (approximate amounts)
			<i>Per ct</i>	
Boston	\$ 55,800,000	\$165,400,000	62	\$100,000,000
New York	121,100,000	548,100,000	92	45,800,000
Philadelphia	39,100,000	108,500,000	66	56,200,000
Cleveland	42,100,000	160,000,000	79	42,000,000
Richmond	23,100,000	52,400,000	59	36,200,000
Atlanta	21,600,000	36,100,000	78	10,100,000
Chicago	24,400,000	141,300,000	52	131,400,000
St. Louis	19,900,000	59,900,000	92	5,100,000
Minneapolis	4,600,000	30,000,000	56	23,700,000
Kansas City	15,400,000	52,200,000	84	10,000,000
Dallas	3,800,000	24,300,000	66	12,300,000
San Francisco	14,700,000	80,200,000	54	68,800,000
Total	\$385,600,000	*\$1,458,400,000	73	\$541,600,000

* The daily Treasury statement of June 30 reports total Liberty Loan payments to that date \$1,385,024,456.38. The difference between that figure and those given above is due to the fact that the Treasurer had not received official advices through the mails of the full amounts, which came by telegraph. Consequently, the difference is in transit to the Treasurer.

Complete data embodying the returns received by the Treasury Department are presented in the above table, which shows that the amount of the subscriptions remaining payable immediately following the June 28 installment was less than \$542,000,000.

While the returns thus show that an unexpectedly small proportion of the \$2,000,000,000 of securities issued was taken by the community subject to the privilege of paying by installments, and while the figures furnish no direct evidence as to the distribution of the bonds between the banks and the public, it is estimated that the banks of the country actually took for their own account only a small proportion, less than one-fourth and probably less than one-fifth of the new issue. The amount which they have assisted their customers in carrying can not as yet be stated, but the figures so far available show that it has been but a small part of the total. This is equivalent to saying that a large fraction of the issue may be regarded as having been "absorbed." The volume of bonds which are still awaiting placement in the hands of investors is not large enough to cause any material change in the liquid condition of the banks, particularly in view of the fact that a considerable proportion will undoubtedly be absorbed at an early date through the liquidation of loans by the partial payments of individual buyers and investors. Most of the bonds have thus been taken by actual and ultimate investors, the banks acting primarily as intermediaries and distributors. Conditions in the financial market as affected by the placing of the loan are thus well protected. Great credit should be given to the banks of the country not only for their actual support and the hard work they have done in connection with the operation but also for their general observance of sound principles of finance in the disposal of the new securities.

Notwithstanding that the process of absorbing the Liberty Loan bonds was proceeding satisfactorily, and notwithstanding the fact that the slight extent to which the banks had relied upon the Federal Reserve System for funds to be used in carrying the bonds, the Board thought it desirable on July 14 to extend, subject to cancellation, the term of the permission given in its circular letters of May 22 and ~~June 9~~, which had provided for the rediscounting of nonmember bank notes under special conditions.

THE RESERVE SITUATION

The banking situation growing out of the subscriptions to the Liberty Loan has been in some measure obscured by the fact that the reserve transfers necessitated by the amendments to the Federal Re-

serve Act which concentrated reserves in the hands of Federal Reserve Banks became effective on June 21. As noted in the last issue of the Federal Reserve Bulletin the Board suggested to the Federal Reserve Banks that they permit the new reserve payments to be made gradually giving the reserve city and country banks until July 15. The condition of the reserve banks as reported in the weekly statement for July 21 is, therefore the first in which approximately the full effect of the new reserve requirements is exhibited. That statement shows the cash reserve in reserve banks as \$1,430,000,000, an increase of \$183,000,000 over the figures of June 22 which represented conditions as they were just prior to the changes resulting from the amendments to the Federal Reserve Act adopted June 21. The sum mentioned includes \$116,000,000 liquidated investment besides transfers of reserves in accordance with the amended act. This transfer of reserves in cash is practically that which was anticipated by the Board in its statements with reference to the effect of the amendments made public from time to time during the discussion of the legislation while pending in Congress. The provision of the amendments permitting the establishment of clearing accounts by nonmember banks which desired to avail themselves of the clearing and collecting provisions of the Federal Reserve Act has already been availed of in a few cases. A new item representing these accounts has been introduced into the Board's general statement of condition but the amount of it—\$4,767,000 on July 21—shows that the opportunity has thus far been used by nonmember banks in a limited degree. It is safe to say that there will be a much larger use of this facility in the future and that consequently the process of shifting cash to Federal Reserve Banks has by no means reached its limit. The same statement may be made with reference to the authority granted in the new act to issue Federal Reserve notes based on gold and gold certificates as collateral.

GOLD IMPORTS AND EXPORTS

The gold export and import situation deserves notice in connection with the reserve position.

Resumption on a large scale of gold imports and increasing gold exports, mainly to the Far East, Spain, and South America are indicated by the weekly reports of the United States customs collectors to the Federal Reserve Board. Gold imports were particularly heavy during the weeks ending June 22 and July 6 when large consignments of gold from Canada were received at New York and largely taken

by the New York Federal Reserve Bank For the four weeks ending July 13 the net inward gold movement was \$63,179,000, gold imports during the period amounting to \$129,730,000 and gold exports to \$66,551,000

The increase in the country's stock of gold through net gold imports since August, 1914, appears from the following exhibit

GOLD IMPORTS AND EXPORTS INTO AND FROM THE UNITED STATES FROM
AUGUST 1, 1914, TO JULY 13, 1917

	Imports	Exports	Excess of imports over exports
Aug 1 to Dec 31, 1914	\$ 23,253,000	\$104,972,000	*\$ 81,719,000
Jan 1 to Dec 31, 1915	451,955,000	31,426,000	420,529,000
Jan 1 to Dec 31, 1916	685,745,000	155,793,000	529,952,000
Jan 1 to July 13, 1917	518,569,000	220,361,000	298,208,000
Total	\$1,679,522,000	\$512,552,000	\$1,166,970,000

* * Excess of exports over imports

RATES OF INTEREST

The Federal Reserve Banks have not found it necessary to raise their rates of interest at any time either during the Liberty Loan subscription period or during the subsequent transfers of reserve funds Their conditions of accommodation have continued upon the same basis as during the spring months of 1917, acceptances being discounted at about $3\frac{1}{2}$ per cent, while other commercial paper in the interior has ranged from one-half per cent to 1 per cent higher, according to maturity Interest rates at member and other commercial banks have likewise continued generally moderate In many cases the banks of the country have accommodated their customers who were purchasing Liberty bonds at the rate borne by the bonds themselves— $3\frac{1}{2}$ per cent—without any margin of banking profit The only important exception to this generally low level of interest charges was observed on July 16 and 17, when call money in New York for a few hours rose to 10 per cent, closing at 6 per cent

It may be well to recall that the framers of the Federal Reserve Act had in mind facilitating trade and commerce by putting commercial trade paper on a preferred basis It is therefore no criticism of the new banking system that call loans on stock exchange collateral

should occasionally run above the low figures which have long prevailed

SUCCESS OF THE LOAN OPERATION

The remarkably satisfactory condition existing generally in the money market during the past month is the greatest perhaps but only one of the many indications pointing to the eminent success with which the banking and financial operations attendant upon the placement of the new bonds have been conducted. The fundamental element of this success is seen in the policy early adopted by the Treasury of permitting the funds subscribed by customers or banks to continue on deposit in such banks provided the latter would qualify as Government depositories until such time as these funds were required for disbursement to cover the expenses of the Government. Through the medium of the Federal Reserve Banks the funds were then placed to the credit of the Treasury Department and have been disbursed without the withdrawal of actual cash from the banks or the market. Under the Board's rulings establishing special rates and special maturities for the accommodation of both member and nonmember banks there has always been available an adequate supply of accommodation for the use of any banks which might find themselves temporarily short of funds as the result of the shifting of the Government's credits. The operation in the large sense of the term was simply a transfer of bank credits on the books of the bank first to the ownership of the Government and then to that of the corporations and individuals who were supplying the goods and services required in the conduct of the war. This operation unprecedented in its size and scope in the financial history of the United States is a striking demonstration of the usefulness and capacity of the Federal Reserve System.

REAL STRENGTH OF THE SYSTEM

There has been considerable discussion during past months regarding the 'expansive' power of the Federal Reserve Banks under the provisions of existing law. This discussion has experienced a marked revival since the amendments to the Federal Reserve Act became law on June 21 and in some quarters it has been suggested that the amended act opens possibilities of 'inflation' of the banking and credit system of the country.

When all has been said however, it should be emphasized that the real strength of the Federal Reserve System is not to be measured mainly by its expansive powers but by the assurance it affords of

furnishing relief where needed, and for shifting available reserve funds readily from one part of the country to another. The effectiveness of this power to extend prompt but temporary aid has been strikingly illustrated during the recent Liberty Loan operations, and in a less conspicuous way during the crop-moving seasons of the past two years. So largely has the reserve strength of the banks exceeded any immediate necessity for its use that the transfer of banking accommodation from one part of the country to another through the application of the process of rediscounting between Federal Reserve Banks has never been necessary. The several Federal Reserve Banks have stood ready at all times to furnish this intra-system accommodation designed to equalize funds between different sections of the country, and to put all the strength of the system, acting as a unit, at the service of any region or locality which might feel the stress of exceptional need. Some measure of relief of this type has, however, been realized through the gradual growth of the discount market and the purchase of bankers' acceptances originating from transactions in various parts of the country. The system's holdings of such acceptances have increased materially during the past month, the amount of bills bought in open markets held on July 20 being nearly \$200,000,000, as compared with about \$84,000,000 at the opening of May. This increase in the holdings of acceptance paper represents a corresponding volume of support extended by the Federal Reserve System to banking institutions. The influence of this form of accommodation is national rather than local, regardless of the particular place or market in which the actual purchase of the paper representing these acceptance transactions was made.

CHAPTER L

NEW LEGISLATION

Desire for Change

The question of amending the Federal Reserve Act had been steadily considered practically from the organization of the Federal Reserve Board.¹ As has been seen at an earlier point, the act was not at all satisfactory to most of the members of the Board, and several of them manifested a determination to change it as soon as practicable. During the first two years of the system however, they had succeeded only in securing a modification of the law, designed to permit the organization of foreign trade banks whose stock should be subscribed by member banks, thus giving them the power, instead of establishing branches, to unite for the purpose of creating jointly owned and operated institutions. This enactment will be referred to at a later date. It has no bearing upon the early history of the federal reserve system, because of the fact that the system has never yet entered actively into foreign trade financing. The policy with respect to foreign trade and foreign discounting is, therefore, essentially a side issue in the history of the development of federal reserve mechanism.

¹ Senate Bill 4960 "proposing an amendment to Section 14 of the Federal Reserve Act relating to reserves and for other purposes," was introduced in the Senate read for the first time and referred to the Committee on Banking and Currency on March 19, 1914. It proposed to authorize state banks or trust companies to keep their reserves with other state banks or trust companies for the three years provided in the original act, where the law permitted it to be done under state statute. Mr. Owen asked several times for a unanimous consent agreement for the consideration of the bill but he did not succeed until the 27th of August when the bill was reported to the Senate without discussion, read the third time and passed. Like speed of action was obtained in the House where the bill passed on the 7th of August. The President approved and signed the amendment on the 12th.

The law as it stood Mr. Owen feared would have removed some of the deposits which were held by the state banks and trust companies as reserves for other state banks and trust companies. It was thought best not to interfere with the existing order more than was necessary in the establishment of the federal reserve system and especially to avoid subjecting state institutions to discrimination.

But this minor modification was by no means the topic of principal interest to those who sought to secure far-reaching changes in the act. Earlier in this discussion it has been shown how attempt was made to reduce the number of districts through administrative action on the part of the Board, for it was well enough recognized from the very beginning that, with Congress composed as it was, there would be no use in seeking reduction through legislative action. A different view was, however, entertained concerning the acceptance power and concerning the use of notes in the reserves. A broadening of the provision of the act in both these cases had been earnestly desired by some of the financial interests that had been dissatisfied with the terms of the Federal Reserve Law from the very start. Consultations of a non-official sort with the leaders in Congress had not, however, given very much encouragement to the view that amendments could be obtained through Congressional enactment. The opinion prevailed more and more generally among the members of the Board during the year 1916, that the most effective results would probably be obtained by uniting a number of features into a joint or composite measure which should be offered to Congress as a general plan for the amendment of the law, based upon grounds of public necessity and well-being. Just when to start the "drive" for such a measure was, however, a matter of difference of opinion. The war provided it.

Legislation Desired

During the autumn of 1915,² one member of the Board who had been interested in gathering and sifting the ideas of his colleagues with respect to the legislation which they desired, prepared a memorandum in which he sketched in outline what had been thought and talked of up to that point. This memorandum is of special interest as a historical document because of the light it throws upon the attitude of mem-

² About October 1.

bers toward the act which they were administering during the first two years of its existence. It is therefore given in full as follows, with the note of transmittal to the Secretary to the Board.

October 1 1915

Dear Mr. Willis:

I enclose herewith for your information a summary of changes in the Federal Reserve Act which have been suggested at various times. It is presumed that this matter will come up for consideration by the Board in the near future and may be assigned to a committee. It therefore may be of some assistance to you to have this matter before you in this form.

Yours very truly,

F. A. DRASCO

Mr. H. Parker Willis
Secretary

AMENDMENTS OF THE FEDERAL RESERVE ACT TO BE CONSIDERED
BY THE FEDERAL RESERVE BOARD

First. Consider the advisability of amending the *capital stock* provision of the Act, Section 2, reducing the amount of capital stock paid in and thereby the dividend requirement. It has been suggested with a good deal of merit that instead of having half the capital stock paid in one-third would be ample or perhaps the right to the Board to return a portion of the amount paid in subject to the right of again calling for it would be enough.

Second. Amend Section 3 of the Act, in regard to the establishment of branches of Federal Reserve Banks giving the Banks the option of creating 'local agencies' as well as or in lieu of branches. (A local agency might, for exchange purposes exist in a city outside its own district.)

It is also suggested that in the case of a District having a parent bank and one or more branches, provision should be made for a locally resident committee to govern the parent bank in the same way that the branch is governed.

Third. Consider the amendment of Section 10 and the possible readjustment and determination of the relations of the Comptroller of the Currency to the Board the situation provided under the law being somewhat anomalous.

Fourth. Consider amendment of that portion of Section 10 which

provides for *public moneys*, making it clear that our funds are not public funds, at the same time, that Congress may make such audit of the accounts of the Federal Reserve Board as it desires, and that the Federal Reserve Banks have a similar right. In view of the opinion of the Comptroller of the Treasury it may be wise not to press this question.

Fifth Consider amendment to Paragraph "E" Section 11 in regard to central reserve and reserve cities.

Sixth Consider whether we may not strengthen or improve Paragraph "k" Section 11 in regard to *trustee powers*, adding for example the right to act as "Transfer Agent."

Seventh Amend Section 13 so that Federal Reserve Banks will be allowed to receive deposits of banks and bankers other than member banks, for exchange purposes only.

Eighth Amend Section 13 so as to permit the rediscount of *domestic* acceptances under limitations and safeguards as to documents etc.

Ninth Amend Section 14 so as to widen open market powers by permitting the purchase of "*foreign checks*," etc. Also grant the right to make paper acquired under this Section, when endorsed by member banks, suitable collateral for Federal reserve notes.

Tenth Amend Section 15 so it will be more explicit in regard to Government deposits, giving the Board the right to determine adequate reserves which shall be held against such deposits, subject, of course, to the minimum provided in the law.

Eleventh Consider the amendment of Section 16 regarding note issue and permissible regulations thereunder.

Twelfth Clarify that portion of Section 16 pertaining to *check* clearing, granting to Federal Reserve Banks the right to clear or receive for collection checks of solvent nonmember banks.

Thirteenth Amend the provisions of Section 18 in regard to refunding United States bonds, changing the word "permitted" to "required" (Page 20, Line 26, Index-Digest). Note in this connection that this Section provides for 30-year bonds although the charters of the Federal Reserve Banks are limited by the Act to twenty years (Law Department says there is no legal objection to this).

Fourteenth. Amend Section 19 in regard to payment of reserves so as to provide for earlier completion of the payments. Also provide that it shall be optional with the member banks to keep as much of the reserves which they are now required to carry in their own vaults, in the vaults of the Federal Reserve Banks.

See proposed paragraph (m) of Section 11

(m) Upon the affirmative vote of at least five members the Federal Reserve Board shall have power to permit member banks to carry in the Federal Reserve Banks or the respective districts the portion of their reserves now required by Section 19 of this Act to be held in their own vaults

Fifteenth Amend Section 21 in regard to bank examinations so as to clarify it and also avoid the possibility of the duplication of examination and reports

Sixteenth Amend Section 22 the penal statute This should be cleared up and the rights of counsel or attorneys defined Penal statutes or regulations in regard to punishment of counterfeiters should also be added and consideration given to the amendment of one section of the Coinage Act covering the same matter (See amendments to Sections 5208 and 5209 of Revised Statutes proposed by Warren & Elliott)

Seventeenth Amend Section 24 so as to permit loans on city real estate as well as on farm lands under proper restrictions

Eighteenth Amend Section 25 in regard to National Banks owning foreign branches so as to permit these banks to own stock in banks especially chartered to do business in foreign countries (See Section 57 of Proposed Aldrich Act)

Nineteenth Consider an amendment of Section 9 for admission as special or associate members Mutual Savings Banks or Building and Loan Associations

AMENDMENTS OF NATIONAL BANKING ACT

It is the consensus of opinion that the National Banking Act should be liberalized in several particulars with the view of enabling National Banks to compete effectively with State Banks

- (a) National Banks should be authorized under proper restrictions to invest to a moderate extent in real estate,
- (b) They should be permitted to have branches in the same city or county
- (c) They should be permitted to sign as acceptors of domestic acceptances under proper restrictions
- (d) The restrictions of the Coinage Act in regard to National Banks directors as compared with State banks directors should be considered and perhaps modified,
- (e) A recodification of the National Bank Act ought to be considered
- (f) Prohibit the use of the word "Federal" in the title of any bank

Draft of Oct 1, 1915

Review of Situation by Advisory Council

The discussion of amendments also gave rise, at about the same time, to a review of the situation by the Federal Advisory Council, which was summarized as follows

November 17, 1915

The Advisory Council at its meeting held in Washington, November 16, suggested several amendments to the Federal Reserve Act, the chief among which are given below. These amendments have not received consideration or action of any kind by the Federal Reserve Board

1 That the work of the Office of the Comptroller of the Currency be absorbed and administered by the Federal Reserve Board

2 That Section 24 of the Federal Reserve Act relating to loans on farm lands be amended to read as follows

"Any national banking association not situated in a central reserve city may make loans secured by improved and unencumbered farm lands situated within its Federal reserve district, or in an adjoining district provided the land on which the loan is made is within one hundred miles from the office of the bank making the loan"

3 A reduction of two-thirds of the present paid-in capital of the Federal Reserve Banks leaving the subscribed capital and double liability as now constituted

4 That the Federal Anti-trust Act be amended so that the second paragraph of Section 8 will read as follows

"No bank, banking association or trust company, organized or operating under the laws of the United States in any city or incorporated town or village of more than two hundred thousand inhabitants, as shown by the last preceding decennial census of the United States, shall have as a director or other officer or employee *any person who may be connected in either of these official capacities with more than one* other bank, banking association or trust company located in the same place. Provided, that nothing in this section shall apply to mutual savings banks not having a capital stock represented by shares. Provided, further, that a director or other officer or employee of such bank, banking association, or trust company may besides being an officer or director in one other bank be a director or other officer or employee of not more than one additional bank or trust company organized under the laws of the United States or any State where the entire capital stock of one is owned by stockholders in the other. And provided further, that nothing contained in this section shall forbid a director of Class A of a Federal reserve bank, as defined in the Federal Reserve Act, from being an officer or director or both an officer and director in one member bank"

5 That the Anti-trust Act be so amended as to permit joint stock ownership by national banks or banks organized to do business in foreign countries through branches established therein

6 That the National Bank Act be amended to permit the establishment by National banks having an unimpaired capital of not less than \$1,000,000 of branches, provided that no branches are placed outside of the limits of the city where the bank itself is located

Upon the request of the Board for the views of the Council as to whether Federal Reserve Banks can do anything with their member banks to discourage or put a stop to the present high rate of interest on demand deposits, the Council held that the rate of interest paid to the public on deposits is regulated by the accumulation or lack of it of wealth in the communities in which the banks do business

The Council also passed the following resolution

"That this Council is unalterably opposed to any provision whereby farm loan bonds described in the Hollis Bill may become security for loans from Federal reserve banks and to their being made a basis for acceptances by member banks

Choice of Amendments

Few, however, believed that drastic and far-reaching changes in the Federal Reserve Act with regard to some of its most fundamental provisions could be obtained under any but extraordinary circumstances. But when the nation became definitely involved in the European conflict, the opportunity was afforded for urging upon Congress the amendment of the act with a view to promoting, so it was said, the credit extending power of the system. The decision to bring these matters before Congress gave rise to numerous conferences among members of the Board as a result of which an amendatory measure was tentatively drafted and it was agreed to put the full weight of the Federal Reserve Board behind it. In the first instance it was determined to include three main subjects of change, as follows

- 1 Enactment of substance of the Board's regulations relating to membership of state banks so that they should have the sanction and stability of law instead of resting merely on administrative ruling

- 2 Provision that federal reserve notes might be used as reserves in the vaults of member banks
- 3 Broadening and easing of the acceptance powers in order that the larger banks of the cities which were at the time practically the only acceptors, might have a greater amount of access to the discount market and, of course, to the facilities of the federal reserve banks themselves

These provisions, however, were not destined to reach Congress in exactly the form which was thus given to them. There was very decided opposition on the part at least of one or two members of the Board to the idea of permitting the bank notes to act as constituents in the reserves of member banks. That policy had always been open to criticism—so much so that in the National Banking Act all banks had been forbidden to count or report notes as a part of their reserves. The opposition to bank notes as constituents in reserves of other banks had almost become a classic subject of controversy and, as will be remembered, the Federal Reserve Act itself had observed this teaching of experience by forbidding the use of notes in reserves. Yet a colorable criticism could be and was offered by those who asserted that the opposition thus manifested was illogical. There was, they said, no good warrant for permitting deposits on the books of reserve banks to count as reserves for members at a time when notes were forbidden. Hence the demand that notes be allowed to figure in the reserves—a request which had very strong support of many member banks which believed that their convenience would thus be greatly furthered. The members of the Board, however, advocating this legislation were wisely reluctant to go before Congress with any request which would not have the unanimous support of all members. Lacking that, they thought there would be serious question as to whether their proposals were or were not really demanded in the interests of war

financing. Hence, the necessity, if possible, of winning over their recalcitrant associates.

Curtailment of Reserves

A preliminary draft of amendments was submitted in the Board's Report for 1916, published early in 1917, but protracted conferences on the form to be given to the legislation proceeded during the winter and spring. In the month of April, 1917, they almost reached a deadlock, when the suggestion was made that in lieu of allowing reserve notes to count as other reserves, the act simply make a reduction in percentage of reserves required, and specify that the whole of this reserve must be carried in reserve banks thus leaving the members to carry as much or as little available currency in their own vaults as they chose and to let it consist of any kind of currency that they chose. In effect the change in the provision was a compromise. It strengthened the amount of reserves to be carried with reserve banks, it yielded the content of the other cash—now to be known as "till money"—and in so yielding markedly increased the inelasticity of the reserve notes by allowing them to be kept practically indefinitely in the hands of members. The compromise had a good deal to recommend it to both sides in the controversy. It had been felt for some time past that the strengthening of the balance with reserve banks would be a good thing, particularly in view of the war. Yet the Board had not felt like recommending it because of the supposed hardships that it might inflict on some banks.

While the matter was hanging fire it was suggested as a further concession to the strict constructionist party, that the final installment of reserves, which had not yet been paid and would not be for some time to come, be made payable immediately. The strict constructionists would thus get an immediate concentration of reserves in reserve banks, enlargement of reserve resources, and a concentration of the entire reserve held with reserve banks. The opponents, or "reformers," would

be able to say to member banks that they could now keep anything they chose, including reserve notes, in their vaults, and that no hardship had been inflicted upon them since a very material reduction in the total amount of reserves had been effected, although the balance to be carried with reserve banks had been increased. The compromise was one of those double-faced arrangements common in legislation and objectionable because it entirely sacrificed principle while seeming to salve the feelings of both sides. It was, however, about the only way that the reserve provision could be insured of at least the passive support of the Federal Reserve Board. Finally, a tacit agreement on this basis was arrived at.

Broadening the Acceptance Powers

A number of member banks had begun to use the acceptance in a fairly extended form, and had found it very profitable. It was a cheap and easy way of getting accommodation at reserve banks, and it was proving of considerable assistance in financing foreign trade. They did not, however, like the strict limitations to which the acceptance power was subject in the original act, and they desired both to have the authority broadened and at the same time the conditions of acceptances issued made permanently easier. Hence the strong demand from banking sources for some kind of legislation. When the proposal first came up in the Federal Reserve Board, it, like the reserve modification, was urged on the ground that it would assist in financing the war, and after the United States had entered the war this argument was pressed forward in full strength. Although some members of the Board feared the acceptance and realized that it had already become the vehicle of great banking abuses, they were disposed to think that the broadening of the power might be useful in connection with war financing, while they also felt that with due activity on their part they would be able to prevent abuses. The subject, therefore, never received very detailed discussion in the Board,

and after the reserve modification had been agreed upon coupled as it was with the change in the status of reserve notes, the acceptance plan more or less easily made its way through to admission into the final draft.

Amendments Ostensibly to Strengthen System

The question of amending the act along these lines, although given very careful consideration by the Federal Reserve Board during the early spring of 1917, became much more urgent after our declaration of war, and action was undoubtedly furthered by the fact of the war itself and by the belief that the proposed legislation would strengthen the system to meet the emergency. Everyone admitted there would necessarily be very trying demands. No one, of course, was able at the time to make any forecast of the scope of the probable financing, indeed, as elsewhere seen, it was not until after the war had been in progress for a good many weeks that our financing program began to take a definite shape. Most were of the opinion that the financing of the war would be a task of great magnitude, however, and that nothing that could be done to meet it would be more than was needed. Undoubtedly this feeling gave the basis for the acceptance of legislative proposals which otherwise would not have been seriously thought of.

In all this discussion there was but little consideration of the question of limiting the changes made to the duration of the war. So far as that subject was mentioned at all, it was usually with the reservation that we must act as if the war would be a very long one, and as if, therefore, everything that was to be done should be done with a view to making semi-permanent preparation for it. If the war should end unexpectedly soon, it was thought, the remodeling of the act would be easy enough and in any case could be deferred until that time. Conscious as all were that the Treasury was in an unsatisfactory condition and that the brunt of the war financing

must necessarily fall upon the reserve banks, the attitude adopted toward the legislation was on the whole somewhat uncritical. The proposal to change the reserve provisions received by far the greatest amount of discussion, but it was apparent that this modification would greatly enlarge the credit extending power of the reserve system, and there was therefore ample disposition to apologize for it on that ground. Much the same view was taken of the changed provisions as to acceptances and the various amendments relating to state banks. The latter set of changes did not involve any new departure but were, as already, seen, quite in line with the regulations which the Board itself had already accepted.

Knowing that the larger non-member institutions were disinclined to enter the system on the basis of regulations merely and desired a legislative assurance of the continuance of these regulations in effect, the Board was disposed to adopt an almost unanimously favorable attitude toward the enactment of these regulations into legal form. Indeed, at this juncture, as will presently be seen, there was a very general feeling that it was nearly essential to obtain the collaboration of the state banks in order that war financing might go on as perfectly and as smoothly as possible. When the draft of amendments had been prepared, it therefore went to Congress with what amounted to the united indorsement of the Board even though serious mental reservations were naturally entertained by some members.

Action in Congress

The enactment of the law as thus proposed by Congress followed smoothly and speedily.^{*} Congress, too, had got the war fever and was inclined not to haggle or stickle about details. The prestige of the federal reserve system had steadily grown as the result of careful and conservative management, and while its war service was still to be demonstrated, there were

^{*} See Appendix for text

few really disposed to question the great aid that it could render or to withhold strength that might lend power to it. Debate in Congress, therefore, was limited in its scope and unenlightening in its character, the result being the prompt enactment of changes in the system which, taken together, constituted an innovation, not only upon the technique, but upon the original theory upon which the act had been framed, and whose importance cannot be overestimated.

Significance of Legislation

The significance of the legislation from the broader banking standpoint must not be overlooked. Important as were all of the amendments thus enacted in 1917, the one which stood out as fundamentally important was that which changed the reserve situation. This modification, as already indicated, was a direct breach in the entire theory of the Reserve Act. In the original act provision had been made for a threetold reserve. This included (1) a deposit with the reserve banks of a compulsory amount, (2) a holding of vault cash also compulsory up to a minimum sum, and (3) an intermediate amount which might be held in vault or transferred to reserve banks. The theory of the act had been that in times when reserve banks needed greater strength they would so alter their policy and adjust their rates as to attract this variable element of reserves to their own vaults, while at times when credit could properly be relaxed they would repel it and thus transfer to member banks the responsibility for enlargements of the volume of credit in the market, enabling them to proceed regardless of reserve bank policy. This plan was substantially developed upon the experience of the Bank of England and represented an adaptation of the 'private' and 'public' rate policy and practice of that bank. It had been recognized from the first that the adoption of two different rates, one private and the other public, was probably not feasible for use under American conditions. Hence the necessity of greatly enlarging the open

market powers of reserve banks and of loosening the rigid reserve requirements in such a way as to permit of a large shifting of credit between reserve and member institutions

Whatever may be thought of this theory, there had been no opportunity to test it even in the slightest degree, for reasons which are already apparent to the reader. The new amendments abandoned the older theory and substituted for it the notion of obtaining and holding as large a proportion of reserve funds as possible, with a view to having at all times on hand a vast credit-granting power. Those who believed that reserve notes would figure largely in the reserves of member banks also predicted that this change—which had in effect although not in name been included in the amendments—would likewise greatly strengthen the credit inflating or extending power of the system. As to this there could be little doubt, as events were subsequently to prove, though it may well be questioned whether by massing the inflating or credit-extending power in the hands of reserve banks a better or more far-reaching result was attained than would have been reached had power been allowed to continue resident in the hands of the individual banks subject to an effective control of the credit to be exerted by the federal reserve system itself. The latter view is the one which has always been entertained by the author and is based upon the past experience of European countries, so that those who advocate a “scientific system” in banking should undoubtedly lend their support to it.

It may be conceded that credit inflating or expanding power may perhaps be more promptly used when actually in hand and available to the central banking system, although even this is open to question where central banking mechanisms are ably and effectively operated. This is a question of abstract banking theory which finds no field for general discussion in the present book. It is enough to point out that the theoretical credit-expanding powers of reserve banks was enormously increased by the amendments of 1917, and that the direct

ability to inflate credit as a result of government or other demand was correspondingly broadened. This was, in fact, the purpose that was had in mind in making the amendments, and had it not been for the war conditions it may well be doubted whether they would ever have found acceptance. It was an unfortunate thing for the federal reserve system that they did in fact meet with such acceptance.

The New Enactment

The Federal Reserve Bulletin⁴ furnishes the following computation of the reserve effect of the amendment of 1917, by showing comparatively the amount of the deposits which member banks were required to maintain with the federal reserve banks, namely, \$547,707,000, and the amount they would be required to maintain were the amendment enacted, or \$901,910,000. The total amount of reserve required, which was then \$1,369,315,000, would be slightly reduced, to \$1,332,986,000, the principal part of the reduction being in the requirement for country banks. The figures used were those given in the Comptroller of the Currency's summary of reports for national banks at close of business November 17, 1916, and the formula for computing reserves prescribed by the Comptroller had been used, with the exception that the requirements were computed as they were to be after balances with correspondents had ceased to count as legal reserve.

With the enactment of the amendments of 1917, the Federal Reserve Act undoubtedly embarked upon a new stage of its career. This was not due solely to the fact that it was now about to meet the enormous demands of war finance. Such was of course the case, and these demands could not have failed immensely to alter and modify the structure of the system. But more important than any such influence was the fact that a fundamental and basic change had now been produced in the Federal Reserve Act itself, and that from being

⁴ 1917, p. 110

a scientifically constructed system in which the central banking mechanism was the equalizer or "governor," it had been converted into a system in which the central banking mechanism might at times be the boiler or steam-generating plant of the mechanism. We may say with entire safety that nowhere else in the world had there ever been developed a central banking system possessing the extreme power which had now been vested in the federal reserve system, nowhere was there larger concentration of authority, nowhere could the central mechanism, if so minded, exert itself to produce such far-reaching results, or, if not so minded, exert so great a negative effect by merely withdrawing and leaving matters to take care of themselves. The great scope of the change thus made in the fundamental structure of the system was, it is probable, not fully realized by members of the Federal Reserve Board or by the Congressmen who under the influence of war hysteria forced through the changes which had thus been recommended to them. Perhaps it was inevitable that at some time or other the banking structure of the United States should pass through similar far-reaching transformation as the result of the war, and granting that such must be the case, perhaps it was just as well to have this change occur at the very outset. Granting, however, that it had to occur, there could be no doubt as to its regrettable character nor as to the future influence which it must produce, both in popular irritation toward the system and in the attributing to it of powers and responsibilities which it neither did nor could exert.

It is not the least remarkable element in this vast transformation which, as already explained, came about with practically no discussion—that, so far as there is any record, the Federal Reserve Board never subsequently recommended a return to the older system or the adoption of forward steps designed to modify its war control. The federal reserve system accordingly remains today what it was at the middle of 1917, a war emergency system, possessing enormous authority and

(000 omitted)

As of Nov 17, 1916	Central reserve city banks	Reserve city banks	County banks	Total
Due to banks	\$1 553,234	4 935	4 189	
		1,358,271	128,120	
Less due from banks	265,619	1 363 209	132 309	
		788,380	914 767	
Total	1,267 615	574,829		
Dividends unpaid	105	284	1,001	
Demand deposits	1,960,610	2,015,082	3,316 996	
Total	3 228,330	2 590 195	3 347 997	
Deductions allowed				
Checks on other banks in same place	8 287	7 600	12 405	
Exchanges for clearing house	392 921	106 511	17,273	
Total	401 208	114,111	29 678	
Net demand deposits	2 827 122	2 476 084	3,316,319	
Time deposits	76,272	287,922	1,452 252	
Reserve required to be in Federal Reserve Bank				
13-10-7% on demand deposits	367,526	247,608	232,282	847,416
3% on time deposits	2,288	8 638	43,568	51,494
	369,814	256 246	275,850	901,910
On present basis				
7-6-5% on demand de- posits	197 898	148 565	165 916	512,379
Approximately 2% on time deposits	1,525	5,758	28,045	35,328
	199,423	154 323	193,961	547,707
Total reserve required, new basis (18-15-12%, 3% on time deposits)	511,170	380,050	441 766	1,332,986
Total reserve required, pres- ent basis (18-15 12%, 5% on time deposits)	512 646	385,809	470,810	1,369,315

enormous unused power, differing essentially in its structure from the other great central banking systems of the world, and substituting mere political control over banking assets for that control through financial and economic means which had been gradually developed in England and to a lesser extent in other countries as the outgrowth of many years of financial experience

CHAPTER LI

MEMBERSHIP IN THE FEDERAL RESERVE SYSTEM

Effect of Amendments on Membership

The action which had been taken by Congress in amending the Federal Reserve Act along the lines reviewed in the last chapter, was not without its result. Members began to come into the federal reserve system in increasing numbers. It is possible that there might have been some such increase of membership even without the adoption of the new law. Unquestionably the earlier reluctance of members to enter the system, said to be due to the fact that the conditions of entrance and departure were fixed by regulation rather than by expressed statute, had been considerably exaggerated. Nevertheless it was doubtless the case that some state institutions were more or less influenced by fears of the situation to which they might possibly be exposed should they find themselves members of the system without absolute legal guaranty that they could retire at will. Fairness therefore compels a recognition that in all probability the Act of 1917, by providing a definite legal basis for membership, helped to popularize it.¹

War and Membership

We must not, however, give too much weight to this consideration. The real factor which attracted members to the system most powerfully was the advent of the war and the feeling of state institutions that they would be safer inside than outside, due to the fact that many of them foresaw tremendous and unexpected strain upon their resources. Membership in the federal reserve system was therefore a plain dictate of

¹ See appendix to this chapter

expediency—a wise concession not only to public opinion but to commercial prudence, a valuable means of advertising, and a gateway to possible profits in connection with war loans. It was not strange in these circumstances that many banks and trust companies which had been previously pessimistic about the advantage of membership in the federal reserve system, changed their point of view very drastically. From about the time of the declaration of war, much greater interest began to be manifested in the question of membership, the inquiries received by the Board being far more numerous and the general disposition to arrange for joining the system being evidently on the increase. The movement into the system did not, however, come to a climax until after the adoption of the legislation already referred to, which, as we have seen, may have convinced some doubting Thomases that the good faith of Congress or of the system could be relied upon. At all events, the months of April, May, and June, 1917, must be taken as the turning point in the membership discussion of the federal reserve system, since during these months the sporadic and reluctant movement into it which had been characteristic prior thereto, turned into a direct and steady current of membership applications.

Effect upon Federal Reserve Board

There were many ways in which this movement of banks into the system had a powerful effect upon it. Perhaps the most striking of these was found in the influence it exerted, psychologically speaking, upon the Federal Reserve Board. "We have won at last," exclaimed a member of the Board on the morning when it received membership applications from two large trust companies neither of which was likely to do much rediscounting business with the system. When the character of the two concerns was pointed out to this member, his answer was merely a smiling rejoinder in which he brushed

aside all question of business relations. It was enough that the memberships had been secured.

Why this effect upon the minds of the Federal Reserve Board should have been produced, it is hard to say. Undoubtedly, however, from the very beginning some members of the Board had had the feeling that they had been "sent to Coventry" by the banks. The fact that the national bank membership had been compulsory at the start, the further fact that few state institutions had voluntarily joined the system, the influence of the government over the Board, had all combined to produce a state of things in which members of the Board, and to a lesser extent the official staff of the reserve banks, felt isolated and in some cases almost ostracized. With the popularization of the system through the voluntary entry of large trust companies and state banks, this condition of affairs was more or less modified, and officers and members of the system could now lay the flattering unction to their souls that they belonged to a popular organization which, if not as yet very exclusive, might in time become so. There can at least be no doubt of the complete change in "psychological climate" which followed upon the rush of state institutions into the reserve system during the year 1917.

Some Effects of New Membership

But this popularization, like all movements of the same kind, brought with it its own effects. The new members had not joined the system purely out of sentiment, they wanted to see results. The pressure upon the Board for liberalization of its acceptance rulings and for concessions of one kind or another became tremendous. Banks which were not altogether in very good condition to make application began to stipulate that they should be allowed this or that concession as to their real estate holdings or their excessive loans of one kind or another, or as to kinds of business which they undertook. The question of branches presented itself, the Board having

felt that on the whole it should try to limit the number of branches to be established by state institutions in those states where the branch system was permitted. It was more difficult to maintain a uniform or stable standard of membership, and a day-to-day scrutiny of the conditions under which admissions were made would undoubtedly show that such a uniform or suitable standard was only partially adhered to.

This brought into the system many institutions which really ought not to have been there. They were trust companies or banks doing primarily an investment business and not particularly concerned with the problems which reserve banks had before them. Others were institutions of a primarily savings variety, whose objects and methods were quite out of line with those of the reserve banks. Had the war continued and had the movement of banks into the system been maintained, the Board might have had some very serious problems to deal with in this connection. This was indicated by the agitation which developed among some of the savings banks and among other institutions that were obviously ineligible for membership under the terms of the law, their managers evidently undertaking to obtain membership by straining the interpretation of existing legislation or, if necessary, through action of Congress. The anxiety to get into the system became more and more apparent as the advantages in the handling of war loans and the getting of government deposits growing out of them grew more and more evident. This made the whole membership question one that suddenly assumed a very two-sided aspect.

The Future of Membership

And yet there were a good many institutions which were not content with the present but which insisted upon looking to the future. Some of the larger trust companies who inwardly knew themselves to be unsuitable members of the organization, had taken pains to stipulate when they joined the

system that at the close of the war they would reserve the right to reconsider their membership and that they would probably retire. The effect of this possibility upon the minds of the Board and upon the managers of reserve banks was undoubtedly a disturbing and disquieting one. It made them feel that they might at some future date be subject to the reproach of having "lost members" and that they must do all in their power to conciliate members and to keep up the flow of banks into the system. This tended in many ways to lead to the assumption of functions which probably ought not to have been taken on by reserve banks, in order that through the performance of these duties they might please the smaller institutions which had become members or were contemplating doing so. Coupled with this attempt was the inconsistent effort to keep out of the discount market in any way that would annoy the larger member banks. Thus the whole question of federal policy was further thrown into a confused and inconsistent position. The wrong concept of membership had been adopted and had been followed out from the mere standpoint of expediency. Nevertheless, the actual and practical results of membership were at all events realized.

The following table presents the growth of the system in number of state institutions that were received as members, a striking contrast between the years 1915-1916 on the one hand and the war year of 1917-1918 on the other.

Number of State Members Received			
1915	32	1919	251
1916	6	1920	306
1917 (Jan 1-June 21)	16	1921	140
1917 (June 21-Dec 31)	197	1922	65
1918	666		

National and State Banks

One of the unlooked-for results of what the Board had done in connection with membership was to cause dissatisfaction among the national banks. It will be remembered that the Federal Reserve Act had granted power to national banks

to exercise fiduciary functions when and as authorized by the Federal Reserve Board. This provision had not appeared in the original draft of the Federal Reserve Act, but had been inserted during its later history as the result of demand on the part of national banks which had long felt the competition of state institutions, which were able to exercise these valuable powers and by that means to get hold of business which would otherwise have gone to national banks. The Board from the start had been somewhat chary about granting these privileges to applicant banks, and had wisely adopted the conservative policy of embodying in its regulations on the subject a provision to the effect that every national bank granted fiduciary powers must be guided in the exercise of such powers by local laws prevailing in the state in which such bank was located. This had of course eliminated the possibility of charges, which might otherwise have been made, that national banks had been given a roving commission to enter upon state territory and upset the wise and safe trust company legislation which had been developed there in former years. Moreover, the Board often refused to grant the desired powers to banks unless they were able to show that their condition was unimpeachable. So, on the whole, the fiduciary section of the act had been very carefully and conservatively administered.

Nevertheless, it had aroused the envy and hostility of trust companies who had previously enjoyed an exclusive right to do this kind of business, and who in many states had succeeded in preventing state-chartered institutions engaged in commercial business from exercising similar rights. From the first it was plain that some ambiguous language contained in the act would lead to trouble and that before very much progress had been made it would be essential to have a test case in the courts. Such a case was presented during the year 1916, was carried to the Supreme Court of the United States, and resulted in a sweeping victory for the principles embodied in the Federal Reserve Act. Congress, the court held, was entirely with-

in its rights in granting these powers and there was no reason why (it was to be inferred from the decision) much broader authority might not have been granted. Accordingly the national banks which had felt some pinch as the result of limitations of the act succeeded in securing on recommendation of the Board a considerable extension of their powers, Congress embodying such legislation in the law of September 26 1918.²

With this growing scope of authority to enter a profitable field of business, national banks were undoubtedly encouraged to feel that they were being given access to something that they could not otherwise have obtained and which in a measure tended to equalize their position with that of the state banks and trust companies. The number of fiduciary applications greatly advanced and by the close of the year 1917 a total of 481 had been granted. This relative degree of satisfaction on the part of national banks was considerably reduced as state institutions began to enter the federal reserve system in considerable numbers. It was still further reduced as state banks, feeling that they in many cases were not at a disadvantage both as concerned competition with national banks and with trust companies, succeeded in obtaining from their own legislatures a broadening of their powers to include fiduciary functions. So, by the opening of the year 1918 there was a growing degree of disaffection and criticism among national bank members, which was held more or less in check by the overshadowing emergency of war but which was certain to produce results later on. The Board, of course, could not be blamed for the growing disaffection of members in so far as it was merely due to the extension of the limits of the system, but it was necessary that they should reckon this as one of the offsets to the "success" which, as already seen, one member regarded as the fruit of an increasing number of state bank applicants.

² See Appendix for text

The Clayton Act

In this connection, too, it is worthy of note that Congress, not long after the adoption of the Federal Reserve Act, had chosen to put into the form of law a statute known as the Clayton Act. This act was intended to broaden the anti-trust legislation in force at the time and had been hit upon by congressional authorities who felt the need of "doing something" on the trust question. Believing also that the "Money Trust Committee" of 1912-1913 under the guidance of Samuel Untermyer, had handed down a new gospel on the subject of Wall Street combinations in the field of money and credit, which had been entirely without honor thus far, it was resolved to incorporate in the Clayton Act a provision whose object it should be to prevent banks from going further in the matter of what were called "interlocking directorates." Those who have followed the history of the Federal Reserve Act will remember that at one point in its development effort had been made by the "progressive" element in Congress to secure the incorporation of a drastic interlocking directorate provision, but had met with no success.

An amendment to the Clayton Act, therefore, was projected and eventually adopted under whose terms it was specified that the number of bank directorships which any one person might hold should, in the case of banks possessing a total of assets in excess of \$5,000,000, be limited to three, while it was required that no substantial competition should exist between such banks. This was nominally for the purpose of obtaining a definite understanding on the subject of Money Trust activities, and of limiting in some measure the growth of "community of interest" among banks. Inasmuch as the provision had been made applicable not only to national banks but to all members of the federal reserve system, it would have tended in some measure to restrict the growth of membership had not the Board, in its administration of the Clayton Act in relation to banking, practically relaxed the operation of the

measure to a maximum extent. This it was not difficult to do because of the extraordinarily loose and vague character of the language used by the drafters of the act and the inapplicability of much that they had put into the law to any practical condition. At the close of its first year of administration of the Clayton Act, the Board indeed announced that it had granted 1,215 applications for authority to hold more than one directorate out of a total of 1,359.

In spite, however, of this laxity and leniency, the Clayton Act provision doubtless tended to restrict membership in the system, for, viewed with the most generous interpretation of its terms, it inevitably tended to subject bankers to a certain degree of oversight and observation which they might otherwise have escaped save in so far as regular bank examinations entailed it from them. To this extent, therefore, a counter-vailing influence was set at work in opposition to the factors whose influence in enlarging the borders of the system has already been, generally speaking, reviewed. The Clayton Act was a blemish upon the system of banking legislation developed after the year 1914. It had no good reason for existence in so far as it applied to banking, protected no one, aggravated rather than cured the evils at which it was aimed, and caused continual annoyance and embarrassment to those in charge of the federal reserve system.

Changes in State Legislation

No picture of the legislative conditions prevailing under the federal reserve system and affecting it would be complete without knowing the very extensive and far-reaching influences which the Federal Reserve Act itself had produced upon the legislation of the states in relation to banking. Partly under the influence of the banks, partly as a result of the efforts of legislators fearful that state institutions would convert into national banks and desirous of retaining them because of their taxable value, and partly as a result of other

considerations, the laws of many states had undergone what amounted to a revolution during the three and one-half years subsequent to the passage of the Federal Reserve Act. These changes in law would in themselves provide the matter for a lengthy treatise. At this point it must suffice merely to indicate their nature. They were in general of three kinds: (1) laws permitting the entry of state institutions into the federal reserve system, (2) laws modifying the local reserve provisions so as to bring them into harmony with federal reserve requirements, or unfortunately in some cases to alter them so as to make non-membership more attractive to banks, and (3) legislation broadening state banking powers through the granting of acceptance authority, power to exercise fiduciary functions, and in other ways.

How far these changes were beneficial and how far they are a subject for criticism, it would be difficult to state in the present brief space. There need be no doubt of the fact that the legislation had greatly facilitated the movement of state banks into the system, not only through its direct permissive clauses but also through the general harmonization and unification of reserve requirements which had been brought about. On the whole, this tendency toward unification and harmony was a desirable one, since it tended to reduce the amount of conflict and inconsistency which still existed between the statutes of many states. In studying the position of the federal reserve system after the war, therefore, and in endeavoring to account for its failure to continue the expansion of its membership, it must always be remembered that during the constructive period of the system prior to the war great progress had been made in the direction of smoothing the path between the several state systems and that of the federal government. Removal of these obstacles should have tended greatly to facilitate the broadening of the membership and for a long time undoubtedly did so.

Ineptitude of Congress

Reviewing the entire period of new legislation which culminated with the amendments of June, 1917, the conclusion is irresistible that so far as financial measures were concerned, the ineptitude and ignorance of Congress were almost unlimited. Not only had it shown no power to improve the Federal Reserve Act, but it had shown itself inclined to allow the most dangerous provisions without hesitation. Many of the latter have been waded off only with great difficulty. As for the actual legislation adopted, it must be judged in the light of war influences, and from that standpoint must not be too severely condemned, yet its total outcome cannot be regarded as other than almost disastrous. The action of state legislators, on the other hand, had on the whole been beneficial, but out of the chaos of conflicting measures and of popular uncertainty there had come about a growth of dissatisfaction and uneasiness among the banking community which must in some way be eradicated, as, if not so eliminated, it would in time bear fruit in an effort to undermine the foundations of the system itself. As for the administrative activities of the Board and particularly its directive efforts in legislation, they had been guided by no uniform principle, and although well meaning had been far too largely controlled by considerations of expediency and by the over-mastering desire for popularity and approval.

APPENDIX TO CHAPTER LI

LEGISLATIVE HISTORY OF THE ACT OF 1917

House Bill 3673 'to amend the act, approved December 23 1913, known as the Federal Reserve Act as amended by the Acts of August 4 1914 August 15 1914 etc.' was introduced on April 23 1917, and reported back on April 27 accompanied by report No 35, and both referred to the Committee of the Whole House. Mr Glass in explanation at the opening of the debate on the 30th of April, pointed to the importance of the matter as illustrated by the fact that

the Treasury Department had officially notified the Committee that these amendments were essential as emergency measures better to solidify the banking structure of the country. The most important of the amendments, Mr. Glass stated, related to the reserve requirements—which were to be reduced in the case of the country banks from 12 to 7 per cent, and in the case of the central reserve city banks from 18 to 13 per cent. The real purpose of this alteration was to bring into federal reserve banks an additional amount of gold of about four hundred million dollars, which meant an additional rediscount power of one billion dollars. The assumption was that in anticipation of the enormous issue of war loans, there would be a great growth of rediscounting. An amendment to Section 9 was intended to liberalize the terms under which state banks and trust companies could enter the system. There had been objection against joining the system on the part of the state banks, because they feared duplications of examinations and reports, and also because of the limitation of the Federal Reserve Act with respect to making loans and to the nature of certain loans. State banking laws, for example, did not always limit a bank to loans not over 10 per cent of its capital and surplus to any one individual or corporation. "It is the opinion of the Federal Reserve Board, which has been industriously endeavoring to cultivate the favor of the State banks and trust companies, that with this liberalization of the terms, upon which they may enter, a great majority of them will enter" (Record, Vol. 55, p. 1581.)

Under existing law, one of the directors of Class C was authorized to perform the functions of federal reserve agent during the inability or absence of that agent. He was not required to give any bond. The new bill changed this provision, so that the federal reserve agent could employ his own deputies and exact bonds of them. Mr. McFadden's amendment to this last provision, that the Federal Reserve Board and not the federal reserve agent should require such bonds from the assistant, was accepted. Another amendment, concerning exchange and collection charges, which was to play such an important part in the consequent development of the bill, was lost on a point of order. Practically the only objection to the bill related to Section 19 of the Federal Reserve Act, the proposal to decrease the reserve requirements. Mr. Hill, from Connecticut, took the ground that it was entirely unsafe to allow a country bank to run without any home reserve, and furthermore, that the lowering of the reserves and the concentration of gold would result in inflation. Mr. McFadden, on the other hand, was of the opinion that 6 per cent reserves were

enough for country banks. 'I seriously question whether it is right to burden these country banks and other members of the federal reserve system with the full burden of carrying reserve requirements to take care of the entire banking situation in the United States, and I contend if they do so they are standing an improper share of maintaining the stability of all the banks of the United States. (1877) Mr. McFadden also contended that the earnings of the country banks had been seriously impaired within the last few years. Mr. Cannon as a champion of the country banks, frankly advocated a return to the old system of paying interest on the reserves. The bill passed the House on the 5th of May.

The Senate Committee reported the bill back with an amendment to strike out all after the enacting clause and to substitute Senate bill 1796 (S. Report No. 1059). The differences between the two bills, as Mr. Owen explained on the 9th of May, were the following. The House bill provided that the Federal Reserve Board was to require the bonds from the assistant federal reserve agent, the Senate bill, on the other hand, authorized the federal reserve agent himself to exact such bonds. While the Senate bill provided that non-member banks maintain a balance with the federal reserve banks sufficient to offset items in transit held for their account. This balance was to be determined by the Federal Reserve Board according to the provision of the House bill. The reserve requirement for country banks was lowered in the Senate amendment to 6 per cent but it required not less than 4 per cent of the demand deposits to be kept as till money. The Senate bill furthermore contained a provision authorizing the exchange of federal reserve notes for gold or gold certificates, a provision which was not to be found in the House bill.

The amendment which Mr. McFadden had offered in the House and which had been lost, was introduced in the Senate by Mr. Hardwick upon request of the American Bankers' Association with the purpose of bringing into the federal reserve Act a provision which up to then had been diligently kept out of the bill as contrary to the basic principles underlying the system. It was to allow national banks to make reasonable exchange and collection charges not to exceed 10 cents per \$100. A letter was submitted from the Governor of the Federal Reserve Board, expressing the Board's decided attitude against such legislation. It referred to the resolution of the tenth conference of federal reserve bank governors calling upon the Federal Reserve Board to use every legitimate means possible to prevent the enactment of the so-called Kitchin bill. But in spite of this strong appeal and

against the opposition of Messrs Owen and Reed, the amendment was adopted in the Senate. The bill passed as amended and a conference was asked for.

When the bill was reported back to the House, it appeared that in the meantime the Hardwick amendment had received such strong support that a motion was agreed to, instructing the House conferees to agree in substance to the Hardwick amendment.

At this juncture another letter was submitted to the Senate, in which the Federal Reserve Board, addressing itself to Mr Glass, called attention to the possibility—by reason of this new provision—of the government having to pay bankers a million dollars exchange charges in connection with subscription to the Liberty loans. Senator Martin's motion to reconsider the vote, whereby the Senate had passed the bill, was considered out of order, so that the bill was left in charge of the Conference Committee.

The Conference Committee offered its report (Conference Report No. 73) on the 12th of June. It appeared that the Senate had accepted the House provision in toto on the reserve section and that it accepted practically all the other provisions of the House bill, including those empowering the Federal Reserve Board to compel reserve banks to establish branches abroad and in this country, where needed. The House conferees, on the other hand, had agreed to the section permitting the federal reserve banks to exchange federal reserve notes for gold or gold certificates. The Hardwick amendment was accepted in substance, with the modification, however, that collection charges should be determined and regulated by the Federal Reserve Board and that no such charges should be made against the federal reserve banks.

The latter point aroused an extended debate. The supporters of the Hardwick amendment took the ground that the amendment if accepted would be the greatest inducement to the numerous state banks to join the system, that there was no reason why the jobbers and dealers should not carry the expenses of collection, but their main assertion was that the conferees had exceeded their authority in agreeing to a modification which meant an essential and vital change of the provision. "They flagrantly and contemptuously disregarded the instruction that the House had given them, and having done so, they come back into the House and endeavor to hide behind the proposition that the House has not the right to challenge their action in disregard of the instructions that the House gave them" (Vol. 55, p. 3524). They therefore proposed that the point of order should be

sustained and that the report go back to the conference in order that the will of the House might be carried out

Mr Glass and his followers, on the other hand, took the ground, that the conferees were justified in accepting these modifications, as the instruction directed the conferees to agree in substance to the Hardwick amendment. Had the motion read that the managers on the part of the House are instructed to agree to the Hardwick amendment, the managers would not have hesitated one moment to carry into effect the action of the House but the very fact that we were not directed to accept the Hardwick amendment in toto, but were instructed to agree only to 'the substance of it, instantly and inevitably suggested to the managers that the House itself was not satisfied with this crude and utterly unjust exaction upon the commerce of the country, but relied upon the managers on the part of the House and Senate to alter the phraseology of the bill and in substance, make it workable" And Mr Glass went on "The managers on the part of the House think that in that particular they have adhered to the substance of the Hardwick amendment because the amendment itself left open the question as to what in thousands of cases, would be a reasonable charge, and left undetermined the question as to who should determine the reasonableness of the charge" (p 3526) In regard to the provision that no such charge should be made against the federal reserve banks, Mr Glass pointed to the injustice which otherwise would be entailed in requiring the reserve banks to collect at par checks of member banks, permitting, as the Hardwick amendment would permit, member banks to make charges against the federal reserve banks

Mr Platt was of the opinion that the House, when it agreed to the Hardwick amendment was under misapprehension and misunderstanding of just what the amendment was ' I do not believe the people have understood that this amendment is a matter not only of check collecting but of paying checks, of making a charge for paying checks drawn on a bank's own deposits' (p 3534) The discussion finally turned into recrimination each side accusing the other of backing the propaganda against and for the Hardwick amendment In concluding Mr Glass summed up the case as follows "Nearly 16000 banks joined the collection system instituted by the Federal Reserve Board These constitute two-thirds of the commercial banks of the country They do 85 per cent of the commercial banking business They do not charge for paying or collecting checks This Senate order drafted by a bank lobbyist and through organized pro-

paganda grafted onto a bill here designed to help banking and facilitate commerce, is merely a statutory invitation to these 16,000 banks, as well as to the small groups doing only 15 per cent of the country's business, to renew this tax on commerce and industry. It is a legislative sanction of an obsolete and vicious practice which has never had the countenance of law and should not have it now" (p. 3618)

A part of the discussion was devoted to that section of the bill which provided for the exchange of gold or gold certificates against federal reserve notes. The traditional opposition of the House towards it was overcome in view of the fact that the provision was defended as an emergency measure. Finally, a motion to recommit the bill was rejected and the conference report was agreed to on the 14th of June. The conference report was accepted in the Senate on the 18th of June after but little discussion. Mr. Owen submitted a communication, written to him by the President, in which the President expressed his regret at the proposed amendment. "I should regard such a provision as most unfortunate and as almost destructive of the function of the federal reserve banks as a clearing house for member banks, a function which they have performed with so much benefit to the business of the country" (p. 3761)

The bill was signed on the 21st of June, 1917

CHAPTER LII

A NEW STAGE IN THE DEVELOPMENT OF THE SYSTEM

Relations with the Treasury

In former chapters it has been seen how the federal reserve system had been accepted by the Treasury Department as practically an unavoidable war auxiliary. It has further been noted how the advent of the war materially changed the current of the work that was being done by the Board, while it gave to the system an entirely new status in the minds of the public. It was no longer an outcast from the administration, but a useful tool in the furtherance of the great work which the politicians had in mind—the winning of the war. It was no longer a suspicious and unwelcome guest in the banking household, but an instrumentality whose proper functioning was necessary for the general protection, to which the bankers, therefore, were inclined to grant the respectful attention that had heretofore been lacking. It was, moreover, now in a fair way to obtain the membership of all of the larger state institutions of the country and to increase its resources correspondingly. Not only this, but it had at length been vested by Congress with a full and complete authority over the reserves of the banks which had probably never been enjoyed by any other banking system in the history of the world. Thus endowed and equipped, and occupying, moreover, a position of unexampled responsibility, the system was fairly embarked upon a new era in its history which must unquestionably be quite different from its early years.

Strange to say, the Federal Reserve Board hardly realized

this change of conditions. The current of events attendant upon the opening of the war had whirled men along in a way that fairly compelled them to forget their own personal interests and prejudices and at times led them, no doubt, to overlook many essential things which a more leisurely observation of world affairs would have made it possible to consider with due care. Probably, therefore, neither the Board nor the system recognized at times exactly how the status of the undertaking had changed. This does not imply that there was any lack of appreciation of responsibility on the part of the Board. On the contrary, the early days of the war unquestionably brought a new recognition of responsibility to every man in government service which in the past he had largely lacked, or at least had never in full measure realized. In this respect the Board was no different from its associates in other branches of the public service. A gratifying feature of early war developments was found in the fact that a greater degree of unity and harmony had supervened and that there was less purely political backfiring and intriguing both in the Treasury and in the reserve system itself.

Fundamental Changes in Prospect

This aspect of the war and of its effect upon the financial status of the country was not different from the influence exerted by the struggle in other directions. It offered an illustration of the good side of war's effects, but was evidently much more than offset by the bad influences which soon became quite as obvious. Indeed, it was not long before the maxim that responsibility brings with it its own troubles, was strikingly exemplified. The Treasury Department, instead of ignoring the federal reserve system and affecting to get along without it, now became anxious to lean upon it at every turn. It offered an easy solution for many of their difficulties and the fact was evident before very long that the Board would be

obliged to face a situation in which it might be compelled to put down the brakes and to say to the Treasury Department that not more than a specified amount of credit could safely be granted. When this position would be reached was, of course, a matter of conjecture on which no one could feel any certainty. As has been seen in an earlier chapter, Secretary McAdoo himself was only fairly clear in his own mind, for a long time after the opening of the war, how much he would feel warranted in demanding. He therefore varied greatly in the extent of his demands and left the Board correspondingly little able to decide what provision it ought to try to make for future financing.

At the beginning of our participation in the war, and soon after the preliminary interviews with some of the foreign countries which had sent representatives here to ask for credit, the Secretary of the Treasury had informal interviews with the Board in which he indicated the probability that the amount of money needed for the balance of the year might run to two or three billions of dollars. This, although an enormous sum, was no larger than had been fully expected, and the Board was prepared to do whatever could be done toward the financing of the preliminary offerings. Within a very short time, however, another interview revealed the fact that for the remainder of the year the estimated necessities were expected to run to fully six billions. For the fiscal year ending June 30, 1918, Secretary McAdoo expressed the opinion that he might probably have to obtain fifteen to sixteen billion dollars. As is well known, his later estimates, made as the war advanced, ran to even higher figures, but these higher estimates came on later, and were largely neutralized by the discovery that not more than a certain amount of money could be spent to advantage in the purchasing of commodities without resulting in an advance of prices so great as to defeat the very purpose for which the expenditure was being made.

Conflict with Treasury

Although the Federal Reserve Board was deeply depressed by the probability that these enormous amounts would have to be carried in large measure through banking methods, at least for a time, it made no definite protest during the development of Secretary McAdoo's first one or two estimates. As his estimates began to rise in amount and as Treasury statisticians and others drawn from outside the Treasury began to devote themselves to a computation of the total amount of wealth of the country and the total amount that could probably be saved if every income recipient set himself to the task of saving, a rather different point of view came to be accepted. The question was very properly raised whether a régime of wild credit had not begun and whether the Treasury authorities, and indeed the administration, had not seriously misconceived what the nation could do or the relationship of banking and credit to the industrial machinery. These fears naturally became more and more accentuated as time advanced. It took only a few weeks of financial experience to bring about a situation in which the Board was, in spirit at least, sharply opposed to much that Secretary McAdoo had in mind. In one sense this divergence of view culminated at meetings held during the midsummer of 1917, in which a firm but positive protest was lodged against the borrowing plans of the Treasury. It was pointed out that the new taxation which was in process of development would not begin to yield anything for a good while, and when it did it would probably never return, even according to the most sanguine expectations, more than four to five billion dollars annually. The Treasury, however, was by this time contemplating an abnormal expenditure at the rate of nearly four times that amount.

Threat of Expropriation

Secretary McAdoo received these suggestions or protests

rather coldly and, after listening to them, merely remarked that the development of such an attitude might quite conceivably bring about a condition in which the government would find it necessary to take over the entire funds of all banks for the purpose of winning the war. The Secretary's idea appeared to be that of possessing himself on behalf of the government of the entire reserve of the country, which of course was already lodged to a very great extent with the reserve banks. The attitude thus adopted seemed to indicate a misconception of the banking and financial problem connected with the raising of these huge sums, but the Board was unsuccessful in its advocacy of a different point of view.

Apparently there was nothing to be done except to go with the current, to attempt to keep the Treasury borrowing to as moderate a figure as the whole abnormal circumstances would permit, and to seek to further the absorption of bonds by savers and in every way possible to facilitate the financing of the war, leaving it to the duly constituted political authorities to make what demands they chose. Short of this course of action, it appeared that the only line of conduct open to the members of the Board would have been that of resigning, and although one or two members at times talked of the adoption of that course of action, it was difficult for any man during the early months of the war to get his own consent to a step which might have been regarded as a withdrawal from the post of duty in time of need. It seemed, and perhaps was, the more courageous policy to remain at the post of duty even though the policies which might be forced by circumstances upon the organization could not be approved by it. This, at all events, was either confessedly or tacitly the position assumed by most members of the organization, and the fact that that attitude was thus accepted, necessarily in itself constituted a factor of first importance in shaping the subsequent growth of the system during the troubled war months.

An Unexampled Financial Aid

The attitude thus adopted was possibly weakened, and anxiety to some extent alleviated, by the remarkable success of the First Liberty Loan and the enthusiasm with which the country at large rose to the necessities of the struggle. It is not too much to say that the federal reserve system, notwithstanding the fact that it had at the time of declaration of war attained only a very modest development, more than fulfilled the expectations of its most sanguine supporters, and afforded a machine of the most tremendous power whose possibilities had never before been properly appreciated. As this fact came to be recognized, it was natural that the feeling of enormous financial power should tend to allay fears that would otherwise have been more insistent. In fact, during the early months of the war the federal reserve banks showed an unexpected power to prevent themselves from becoming "waterlogged" with government securities. The statement of the system at the close of the year 1917 showed, of course, a very great difference from the statement of a year earlier, but still indicated tremendous unused lending and credit capacity. In condensed form the statements compare as shown opposite

Departure from Strict Standards

Another phase of the second period of federal reserve development covering the pre-war and early war months was unquestionably the abandonment of some of the stricter standards which had been enforced prior to that time. Notwithstanding many departures from sound policy and undesirable concessions to expediency, the system had undoubtedly sought to maintain itself upon a level of banking practice that was decidedly above that of the general community. The striking departure from these standards had been seen, of course, in connection with the acceptance policy, yet even that had not been carried far enough to permit a very serious inroad upon

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RESOURCES AND LIABILITIES OF THE FEDERAL RESERVE SYSTEM

RESOURCES		
	Dec 22, 1916	Dec 21, 1917
Gold coin and certificates in vault	\$269,627,000	\$ 524,350,000
Gold settlement fund—Federal Reserve Board	178,811,000	304,601,000
Gold with foreign agencies		52,500,000
Gold with federal reserve agents		746,107,000
Gold redemption fund	1,179,000	17,982,000
Legal-tender notes, silver, etc	6,025,000	48,127,000
Total reserves	455,912,000	1,693,670,000
Five per cent redemption fund against federal reserve bank notes	400,000	537,000
Bills discounted for members	32,297,000	
Bills discounted for members and federal reserve banks		693,509,000
Bills bought in open market	124,633,000	277,943,000
United States government long term securities	43,501,000	50,438,000
United States government short-term securities	11,167,000	58,130,000
Municipal warrants	10,557,000	1,102,000
Due from other federal reserve banks—net	*49,318,000	*41,375,000
Uncollected items		323,574,000
All other resources	3,506,000	2,678,000
Total resources	750,560,000	3,142,956,000

LIABILITIES		
	Dec 22, 1916	Dec 21, 1917
Capital paid in	\$ 55,765,000	\$ 69,852,000
Government deposits	29,472,000	221,761,000
Member bank deposits—net	648,787,000	
Due to members—reserve account		1,389,434,000
Collection items		205,810,000
Other deposits, including foreign government credits		14,258,000
Federal reserve notes in circulation	15,754,000	1,227,642,000
Federal reserve bank notes in circulation—net liability		8,000,000
All other liabilities	782,000	6,190,000
Total liabilities	750,560,000	3,142,956,000

* Items in transit, i.e., total amounts due from, less total amounts due to, other federal reserve banks

the assets of the reserve banks. But with the opening of the war it became plain that there would have to be a great retrogression from former methods of doing business. The government soon appeared as the greatest business enterprise in the country, or perhaps in the world, and from a very early date government paper began to take the place of ordinary commercial paper in large ranges of transactions. This of course meant that such paper superseded commercial paper in the portfolios of banks and that the ideas of prompt maturity, redemption, and the like, tended to be thrust more or less into the background. As to this more will be said at a later point. It is enough to note here that the tendency existed.

We may fairly assert, therefore, that one feature of the second period of reserve development was undoubtedly the relaxation of banking prudence and of strict banking standards, and that this relaxation almost inevitably spread through the member banks of the country at large, besides invading the reserve banks themselves. Questions which had been given thoughtful and careful discussion prior to the advent of war financing were thus practically suspended from further discussion, and the place which had been assigned them was now taken by the entirely new range of problems afforded by the gradual development of the Treasury's policy and the work of actual financing.

Changes at Reserve Banks

Nowhere, of course, was this change in point of view so notable as at the reserve banks themselves. Patriotically responding to the calls of the Treasury, supplemented by the requests of the Board, the banks set themselves to the organization of the financial community in each of the district centers as a Liberty Loan Organization, which should "mobilize," as it became popular to say, the resources of the community into a compact body whose primary thought should be that of getting funds for the government. There can be no doubt that

this work was carried out with unusual efficiency and success, and that the efforts of the several reserve banks, ably seconded by those of the leading members of the financial community, resulted in the creation of a machine whose success and thoroughness in sweeping up the available capital funds of the country and, when necessary, of converting bank credit of the country into purchasing-power on the long-term basis, had never been approached. Whatever may be thought of the policies initiated and pursued by the Treasury Department, it should always be remembered that the bankers, including among them the reserve banks, had only a secondary part in the determination of these policies, 'there's not to reason why.'

So in the study of the war history of the reserve system attention should be given primarily to its success as a going machine rather than to the policies by which it was guided. This is undoubtedly a view which is somewhat at variance with that usually entertained, for both at the time and to some extent later there was a popular impression that the Federal Reserve Board was in no small degree responsible for the type of financing that was resorted to. This was certainly not the case save in the mere matter of technique and application of ideas. The plan of financing was essentially that of the Treasury Department itself and to it must be assigned that measure of general praise or blame which historians in future will grant to it. The effect, however, of this policy upon the entire organization's spirit and tone of affairs at the reserve banks was deep-seated and far-reaching. It brought about a complete transformation, since it not only forced the reserve banks to discontinue their primary attention to the scientific side of the work, but it compelled them to devote themselves largely to the immediate increase and expansion of their staff, to the corresponding reorganization of internal affairs that was necessary, and, as already stated, to the task of securing and using to best advantage the co-operation of the public and especially of the banks.

Subordination of Reserve Board

In this great transformation it might have been expected that the system as a whole would act as a unit and that its principal functions would be directed and dictated by the Federal Reserve Board. But during the early months of the war it had already become apparent that this could not be expected. The Treasury Department early came to ignore the membership of the Board in large measure, to leave to it the performance of routine functions, sometimes under orders and sometimes subject to direction, and to perform its work of war financing through direct communications with the reserve banks themselves. Thus it often happened that important policies were initiated and put into effect without previous consultation with the Reserve Board, which received information only when the policies had been determined upon, and occasionally at a later date.

Of course this attitude on the part of the Treasury Department was destructive to the proper development and working of the Reserve Board, and highly injurious to the development of the proper relationships between the reserve banks and the Board. It could hardly be expected that the reserve banks would manifest an attitude of regard or consideration toward the Board if that organization was not able to command the same kind of respect in the Treasury Department itself. Accordingly the Board undoubtedly began to lose its grasp upon the situation. This fact should be very carefully borne in mind in connection with certain subjects which afterward became matters of criticism with regard to the system. It was during the period starting immediately before the close of the war that the movement toward higher salaries and larger outlays in reserve banks gained stronger headway. The Board at first made strenuous opposition to this tendency, as will be seen at a later point, but in the more notable cases it was overruled by the Secretary of the Treasury—a fact which

has been subsequently testified to on various occasions (as applying to individual cases) by Governor Harding himself. Human nature is so constituted that it is inclined to lick the hand that feeds it, at least so long as the feeding is likely to continue, and the Treasury policy naturally tended to create an impression among reserve banks that there was a greater degree of broadmindedness and generosity in the fiscal department of the government than there was in the Federal Reserve Board.

Building Up a Central Bank

Characteristic, too, of this same period and closely allied with the salary situation to which reference has just been made, was the gradual evolution of the central banking idea. As so fully seen in other portions of this study, the federal reserve system had been initiated upon a non-centralized basis. Local self-government in banking, with centralization so far as necessary in the hands of the Board at Washington, had been the general concept. In the early years of the Board that body, although, as already seen, largely out of sympathy with the principles of the Federal Reserve Act, had been unable to attain success in any of its centralizing plans and had finally settled down to the administration of the federal reserve system in line with the original intent of the law. In all this the Treasury and government in general had been sympathetic. But with the opening of the war it was found far easier and in many ways more efficient to give orders direct to a single bank and to have them repeated by that bank to the others. Moreover, the structure of American finance, centering as it did around New York, had in no essential respect been remodeled during the years since the organization of the reserve system. Accordingly, it was not strange that many matters could be most expeditiously and effectively handled through the Federal Reserve Bank of New York. Not only was it the largest unit of the system but its geographical location gave it better posi-

tion for quick communication with Europe, while the presence in New York of the fiscal agents of the various governments made it practically the only channel through which dealings with those governments could be effectively carried on

Treasury Policy and Centralization

The Treasury policy, from the very beginning of the war, thus tended to centralize business in the Federal Reserve Bank of New York. It became the intermediary through which the agency arrangements with foreign countries were made, it was the central depository to which were transferred great sums of money from other reserve banks for payment to foreign representatives or to the agents of manufacturing concerns which were furnishing munitions. It was the principal factor in the acceptance market, it subscribed for and distributed vastly larger sums of Treasury certificates and of Liberty bonds than did any of the others. During the years 1917 and 1918 it rapidly grew into the stature of a central bank far stronger in personnel and resources, and above all in the support of its own financial community, than were any other of the Reserve Banks. Accepted by the Treasury Department as standing very close to the government and as the channel through which many of the most important announcements were to be made and activities carried out, it in a peculiar sense became the government's own bank. It was able in effect, although usually with tact and some appearance of consideration, to defy the wishes or even the orders of the Federal Reserve Board, while its views or wishes conveyed to the other reserve banks were likely to be of far greater moment to them than were those of the Board itself.

It might be straining a point to regard this development as purely the outgrowth of the war, yet undoubtedly it was in a very genuine way the product of war conditions. The same result might have been attained without the war but would not be likely to have been reached—certainly not without a long-

continued course of development, and certainly not without sustained policy of hostility to the Federal Reserve Board on the part of successive secretaries of the Treasury. War and the necessities growing out of war—the greater issues of appealing to and reaching the financial community in that way, the advantage of using a well-equipped institution closely supported by the financial community—were the considerations which brought about this transformation, a transformation which it was likely to be hard to get away from at a later date. The McAdoo policy in this regard was undoubtedly facilitated by the strong leaning in the same direction, displayed by various of his aides and subordinates who were heartily in sympathy with the idea, which already had some support in the Federal Reserve Board itself.

Thus the close of the war found the federal reserve system far more highly centralized than it could have been expected to become under almost any other conditions. These conditions did not manifest themselves immediately but they grew more and more obvious as the early months of the war passed by and as the struggle assumed a full-fledged condition. It may be doubted whether very much more progress in that direction would have been made even had the war continued considerably longer. It continued long enough to produce serious hazard to the essential structure of the federal reserve system and it centralized it in the way just described. There could have been no more serious or greater injury to the plan if it was expected to work out successfully along the lines of its original intent.

CHAPTER LIII

WAR INFLATION

Financial Precedents

The decisions which had been reached in the First Liberty Loan and the financing attendant upon it were, as was foreseen at the time, chiefly significant as precedents. It was true that the Federal Reserve Board and many other banking authorities had feared that the banks would become overloaded with war paper as the result of the very first loan. Experience finally showed that such was not the case. The first loan appeared to be a great success. It was buoyed up by the knowledge that the federal reserve system was amply able to sustain the load of this financing at any rate, and, more than all else, it was helped by the fact that it was a completely tax-free issue of bonds, and the further fact that the so-called capitalist element in the community was in position to take a great deal of it at the time, while profits which were hunting for a safe place of concealment readily poured into the loan and it was amply oversubscribed. The Treasury was flushed with triumph, the more so as the effect upon the banks was comparatively small. It was not necessary to urge the "borrow and buy" policy to any great extent, although the Board's discount rate reduction had been intended to stimulate precisely that method of financing.

But while thus congratulating itself upon the success of the first great draft upon the nation's fluid wealth, the financiers of the Treasury Department were not able to conceal from themselves the fact that even this enormous sum would not last very long. The demands upon the government had been multiplied with almost inconceivable rapidity. Every

foreign country had come to demand its share of support. The military program of the nation, which at first was supposed to be merely nominal, broadened within a few weeks into an ambitious plan of conscription and in the course of a few months into the possibility of drafting every able-bodied man of mature years. It was not possible for administrators to foresee for more than a few weeks ahead what the probable outcome of this tremendous program of expenditure would be.

Secretary McAdoo, who at first thought expenditures for the first year might reach four billions, enlarged them to six billions, and for the entire fiscal year 1918 from twelve to fifteen billions. Later estimates led him to raise his figures for outlay for 1919 to eighteen billions and then to twenty-four. There seemed to be no limit to the possibilities of expense and in these circumstances it was not long before Treasury authorities fairly settled down upon a copy of the plan which had been adopted in Great Britain—that of anticipating loans by short-term borrowing at banks, the recurrent long-term issues of bonds being used to take up and fund the short term issues. That plan of financing speedily became characteristic and continued throughout the war. This is not the place to discuss nor to characterize it, save in its banking aspects. It has been amply and thoroughly considered by writers who have dealt with the strictly financial and fiscal aspects of the struggle. Yet a brief account of certain phases of it must be given here in order to make plain its bearing upon the federal reserve system.

Plan of War Financing

As has been seen in an earlier chapter, the Treasury during the latter half of 1917 had no hope whatever of raising through taxation any considerable additions to the funds already arising from regular sources. It was obliged to rely, instead, upon loans. The ideal plan, of course, would have been that of following the tried and conservative practice of borrowing from

the public what was wanted, in advance of requirements, placing the unused surplus on deposit in the banks, and drawing it down as fast as needed until it was exhausted. This was undoubtedly what was contemplated by Secretary McAdoo in his first direct announcement. The trouble was that his vision was shortsighted and that he was unable to anticipate—perhaps no one could have anticipated—the immense increase in the requirements that were brought to bear upon the nation. It thus turned out that his long-term borrowing provided him with funds only for a comparatively short period, while, on the other hand, it became more and more evident that neither he nor anyone else could foresee very clearly, even for six months ahead, exactly what the amounts of funds required would be.

This situation brought about, during the months of August and September, a complete reversal of the theory upon which the early borrowing had been planned. Instead of borrowing in advance up to the probable amounts that were needed, the substitute plan called for current borrowing not from the public but from the banks, such current borrowing to be carried on for from three to six months. Since the banks appeared to be fairly well "loaned up" through this method of financing, the long-term or funding loans would then be placed with investors, the purpose of which was to clear the banks of the obligations which the latter were holding for the government. It was seen, perhaps not from the very first but from a comparatively early date, that the difficulty in this plan lay in the fact that the public, when asked to buy these funding loans, would not be able to do it without bank aid, so that what would happen would be that the banks would be relieved of the obligations which the Treasury had given them in direct form but would be forced to carry them in indirect form as notes of customers secured by bonds. It was evident, therefore, that the success of this type of financing was conditional upon not overloading the banks too greatly with direct obligations, and

secondly, upon inducing subscribers to, or investors in, long-term bonds to take them and pay for them with as little borrowing at the banks as possible. Any breakdown in either of these fundamental requirements would necessarily lead, it was conceded, to the gradual water-logging of the banks with government securities, the final result being inevitable inflation, excessive prices, and eventual breakdown.

For the first, however, there was no reasonable objection to the plan of short-term borrowing from the banks, provided that it was not carried too far and gradually the Department developed a system of offering to the banks at intervals of about two or three weeks issues of certificates of indebtedness which were then apportioned among the institutions and were as widely distributed as possible, although the distribution was of course not likely to be as good as that attained by the long-term or funding loans. As for the latter, it was clearly evident that they could not successfully be floated more than about two or three times a year and that to issue them more frequently than that would be too great a strain upon the enthusiasm and effort of the community, to say nothing of the heavy draft they would make upon current savings. Therefore the Treasury Department resorted to various other methods of encouraging saving among the financially weaker classes of the community through the issue of savings certificates, thrift stamps and the like.

Bank Aspects of Financing

This program of financing did not become known or recognized immediately. Like other phases of our war preparation, it was the product of comparatively slow evolution. We did not enter the war with a proper program in any department of activity, least of all in finance. The fundamental idea of pushing the bonds into the hands of the public by enabling the public to borrow from banks at a rate equal to the coupon rate on the bonds had, as already seen, been broached by the

Secretary of the Treasury before the First Liberty Loan and he then had succeeded in inducing the Federal Reserve Board to assent to it. The second phase of the financing—that of placing with the banks the short-term certificates of indebtedness—reached a well-developed stage two months later, and obviously required the assistance of the federal reserve system in exactly the same way—through the extension of rediscount facilities to those banks which were unable to carry the certificates. The problem of the reserve system thus became a continuous one—not merely that of assisting banks to carry periodical funding loans by rediscounting their customers' notes collateralized with bonds, but also that of enabling member banks to carry their own certificates of indebtedness by advancing the funds whenever and as long as they were needed, and leaving the banks to pay them off as rapidly as deposits came in to them and they acquired the capacity to absorb and carry them out of their own resources.

This program, like the program for the placing of the funding loans, was in no small measure a question of rates of interest, and Treasury financiers early made it plain to the Board that a continuously low rate of rediscount must be maintained at a figure that would make it worth while for banks to carry the certificates, either without cost to themselves or perhaps at a slight margin of profit. This, of course, signified that the reserve banks must stand the brunt of the burden and that, if the certificate issues became very large, the reserve banks would find themselves under the necessity of absorbing the surplus in the form of advances to the members who could not take up their "quotas." Indeed, the problem was rendered more serious by the very thoroughness with which the country was organized for the purpose of pushing the loans into the hands of the various banks, large and small. So greatly did the pressure of public opinion make itself felt, that many a bank which would not have subscribed at all or would have subscribed in small quantity, like many an indi-

vidual similarly situated felt it incumbent to take bonds or certificates in an amount far larger than current means would permit, immediately thereafter borrowing funds with which to meet the obligation. Of course, this necessarily meant that the banks found it necessary to resort in an increasing degree to the reserve system, and that the weak banks found themselves especially under this necessity, whereas a greater concentration of the issues might have resulted in placing the burden more closely upon those banks which were best able to bear it. At all events the plan just described was the one pursued.

Board's Attitude on Financing

The attitude of the Federal Reserve Board in these circumstances is well worthy of careful examination. As has been seen, the Board had not been inclined to give its assent to the policy of low discount rates designed for the purpose of pushing the bonds, and later the certificates of indebtedness into the hands of holders.

The attitude of the Board on the whole question was necessarily governed to some extent by expediency. In this case as in a great many others, it was undoubtedly true that members did not think very seriously about the theoretical aspects of the case until they had become fairly launched upon the process of financing. At the outset there was grave reluctance to cut the rate of discount, due to the general feeling that in time of war there was danger of inflation and excessive credit and that, therefore, it was wise to retard the undue growth of credit as much as possible. Low rates were therefore regarded as likely to be hazardous and accordingly to be avoided. Yet as we have seen, it had been necessary to yield to the establishment of these rates. Having once accepted the low rate policy, the Board inevitably found itself bound to follow the natural consequences of the policy to which it had committed itself. One of these was obviously the financing

of the Treasury certificates. About all that could be done, therefore, was to try to have the certificates as widely distributed as possible, and to impress upon the Treasury the desirability of limiting its obligations of this kind as much as might be.

The Board also adopted the view that recurrent Liberty bond issues should be bona fide loans whose proceeds should actually be used for the purpose of taking up outstanding certificates, so that at the close of a Liberty loan the market would be swept fairly clear of certificate issues. Unfortunately, it was not possible to maintain this policy for more than a few months, because of the fact that the necessities of the Treasury soon far outran the proceeds of the loans or the yield of taxation. By the close of the war there were still outstanding certificates of indebtedness amounting to more than three billions of dollars, and it had for some months preceding been true that large issues of Treasury certificates were allowed to "lap over" from one Liberty loan to another, the proceeds of the loan being insufficient to take up the outstanding certificates, while in fact maturities had usually not been so arranged that this could be done. To put this in another way, the financing of the war during the later months fell into a complete jumble. Certificates of indebtedness were floated whenever money was needed, Liberty loans were put on the market as often as it was thought that the public would take them, but the certificate policy was rapidly encroaching upon the funds of the banks. Had the war continued much longer, the formality of converting certificates of indebtedness into bonds, which in turn were used as a basis of borrowing at banks by investors, would probably have disappeared entirely and the country would have plunged definitely into the morass of "fiat credit," as one economist has termed it.

A good deal of this the Board came to foresee as the war months passed by, but it would be difficult to say that at any time during the entire course of the war was there a deter-

mined effort on the part of the organization to restrain the Treasury or to bring about a complete conversion of war financing to some other form. The Board, in other words, to state the criticism severely, was out of sympathy with the Treasury policy but unable to substitute any other that would effectively take its place. It, therefore, necessarily suffered the fate which must always fall to a purely destructive critic—that of being swept along with the current and of being obliged to assent to many things of which it mentally disapproved but which it was unable to prevent because of its lack of foresight or ingenuity.

Growth of Deposit Credits

The situation of the banks of the country had speedily assumed an ominous character which spoke badly for the future. Prices under the influence of the reckless buying and tremendous hoarding of which the government was guilty, started upward with unprecedented rapidity. Before the close of the year 1917, the index number reached an average level of 177, while the bills held by the federal reserve banks and secured by government obligations of various kinds were nearly one billion dollars. This situation can be surveyed more in detail in the combined statement of the federal reserve system already given as of the close of the year 1917.¹

During the year 1918 the conditions thus indicated naturally reached a more advanced point. The resisting power of the country became smaller and smaller and the nation surrendered itself more and more unreservedly to inflationary conditions. Prices by the first of July, 1918, had reached 198, and at about the time of the armistice had advanced to 203. The expansion of deposit credits and the growth of war paper in banks was tremendous. Realizing this situation, the Board was more and more positively determined to urge upon the Treasury and upon the government generally some means of

¹ See page 1207, *anti*.

preventing the wasting of resources, and began from time to time to advocate strict credit control or apportionment as a possible alleviation of conditions of the country at large. This had already been thought of by other branches of the government, notably the War Department, and had been impressed upon the Treasury, which itself had come to believe in the need of some action of the kind. The details of the policy will shortly be surveyed.

Meanwhile it is worthy of note that the fact that the Federal Reserve Board had come to believe in this means of restricting the growth of credit did not appear to encourage any greater faith or confidence in it on the part of the Treasury. On the contrary, the Treasury grew less and less friendly to the Board, and was more and more inclined to ignore its ideas or suggestions as time went on. Secretary McAdoo now seldom attended meetings of the Board, pleading pressure of war work as a good reason for non-participation. He did not, however, fail to express his ideas as to Board policy, sometimes conveying them through Assistant Secretaries of the Treasury or through his own immediate aides, sometimes sending for members of the Board and impressing his views upon them individually. Had this situation continued very much longer the Board itself might almost as well have ceased to function, save in a routine way, since its relationship to banking and credit had become, by the opening of 1918, little more than perfunctory. It still attended to routine business, received reports from the several banks, oversaw the placing of the various Liberty loans and the development of organization at the different reserve banks, and generally directed them. A few members, however, gradually became interested in war work of various kinds, as will presently be seen, and were drawn off into such organizations as Capital Issues Committee, the War Finance Corporation, and others. In the late summer of 1918, the first resignation from the Board's membership occurred, Mr. F. A. Delano announcing his retirement

It is probable that had the war gone on very much longer the Board would have become little more than a routine organization and other voluntary retirements from its membership might have been expected

Hostility to the Federal Reserve Board

The general lack of sympathy with the Federal Reserve Board which, as just seen, had developed during the early part of 1918, had its roots in some obvious conditions. The Treasury was now fairly well equipped with a mechanism of operation. It had developed the use of the gold settlement fund with the aid of federal reserve banks and it had built up in the several banks a competent and efficient local organization. The magnitude of the war and the immense dangers that might come from failure in it, had brought about a very high degree of social discipline and harmonized action among the members of the financial community. There was greater efficiency and greater prospect of unanimity and united effort in the carrying through of war policies than could very reasonably have been expected. Added to this was the fact that the Treasury had successfully organized a Capital Issues Committee and the War Finance Corporation, and had drafted members of the Board into the service of each. Moreover, the Treasury had gradually built up within its own ranks an extensive financial organization which was calculated to make it independent of the Board. This organization included a financial advisor with a full staff to assist him and various experts of one kind or another.

Having practically taken over the direction, or at least the control, of the essential operating mechanism of the reserve system, and having equipped itself with auxiliary bodies like the War Finance Corporation, besides feeling strong in the support of the financial community, the Department no longer felt any necessity of relying upon the advice or service of the Reserve Board as such. In fact, many of the things which

the Board continued to do in a routine or technical way might about as well have been left undone, and it became apparent by midsummer of 1918 that should the war continue very much longer it would exert an unexpected effect upon the entire financial structure of the nation, one incident therein being the complete changing of the organization of the federal reserve system and the practical elimination of the Board at the head of it. As the autumn of 1918 advanced, these conditions grew more and more aggravated and the banking position more and more hazardous. The enormous demands of the Treasury Department, and the apparent disposition of the President to press on without limit of men or money, created a feeling of profound despair on the part of all who were intimately familiar with financial conditions. It began to be accepted as an axiom that the later months or years of the war would be financed entirely upon an inflation basis and that taxation would come to yield a smaller and smaller proportion of the total amount of money required by the government.

Position at the Opening of Autumn, 1918

The inflation problem had indeed reached a very advanced point. Price indexes had risen to above 200 at wholesale. The market had apparently been swept bare of commodities. The average citizen was finding it extremely difficult to supply the necessities of life and to make his income equal his expenditures. The threat of enormous additional drafts of man power raised fears concerning future economic organization. Altogether the finances of the country seemed to be sweeping toward destruction notwithstanding that there was still a very substantial resisting force in the federal reserve system. The statement of the system as it appeared just before the armistice has already been cited on another occasion² and need not be repeated here. It is enough to say that it showed tremendous changes since the beginning of the war, both in holdings of

² Page 1278

war paper and securities, the total discounts aggregating \$1,092,000,000 and notes \$2,507,000,000 while the reserve ratio was 49.6 per cent.

Looking back upon the situation with the experience of later years it is possible to see that the war might have progressed still further without pushing the federal reserve system to the verge of destruction, and yet at the time the tension had become so great that many conservative men feared the worst. In the circumstances, financial morale had been greatly weakened during the year 1918, notwithstanding that the contest had been in progress only about eighteen months or a little longer. War inflation had broken down standards of business ethics in no small degree and had led to carelessness in the application of banking principles. While there was still a long way to go before anything approaching the financial disorganization of Germany, France, or perhaps even England was likely to be reached, the attainment of a condition similar to theirs was well within sight should the floating of Liberty bonds and Treasury certificates be continued upon the helter-skelter basis which had gradually developed itself during the middle of 1918.

CHAPTER LIV

FOREIGN RELATIONS

Foreign Trade Financing

Prior to the organization of the federal reserve system, it had undoubtedly been the opinion of many that one of the greatest weaknesses in our banking system lay in its lack of provision for the financing of foreign trade. This weakness had been found in the inability of our national banks to establish branches abroad, and in the indisposition of the state banks to do more than enter upon the field in a very limited way. It was found also in the fact that lack of the acceptance power prevented the banks of all classes from pursuing the traditional method of foreign trade financing which had been found desirable by most European countries. For these and other reasons a great deal of discussion which centered around the Aldrich bill had been devoted to the question of foreign trade. The Aldrich bill, as will be remembered, had provided for the creation both of branch banks and of foreign trade banks, and had also made provision for acceptances. The Federal Reserve Act had made provision for foreign branch banks, to be established by national banks, had authorized federal reserve banks to create federal branches and agencies, and had made ample provision for the foreign bankers' acceptance.

This bare reference to the drift of earlier discussion, already so fully reviewed, is sufficient to recall to the mind of the reader the emphasis which had been placed upon foreign financing by those who had at heart the development of our trade with other countries. Yet the organization of the federal reserve system evoked but little response from the banking

community. True, as has already been seen there was early development of acceptance regulations, and a meager body of acceptances was brought into existence during 1915. As for the establishment of branch banks by national institutions, there appeared to be an almost complete indifference or dislike for the idea. One large New York institution did take up the matter in serious earnest, establishing a series of branches in the West Indies and in South America and following it with some branches in Europe. Another and much smaller institution established branches in the Canal Zone, and later a Boston national bank undertook on a smaller scale but in a vigorous way the definite exploitation of the foreign field in South America. Beyond these few efforts to employ the machinery provided in the Federal Reserve Act, however, the banking community was quiescent, and it seemed as if there was no prospect of progress.

Inquiries were early set on foot by the Board in an informal way to find out why it was that the provisions of the act were so generally ignored. The answers that were returned were various in their content, as might naturally have been expected, but two general considerations stood out among them. The first was the statement that, under existing war conditions, it was not likely that much progress could be made. European countries, it was noted, were so desirous of getting American goods that they would arrange to finance them in New York on a dollar basis, while conditions in Europe were so disturbed that we could not think of attempting much development there. On the other hand, neutral markets, like those of South America, might be cultivated but they were already ours to all intents and purposes because of the war in Europe, so that we could rely pretty largely on getting their trade financed in our own centers. As against this rather selfish summary of the situation, based as it was upon undeniable truth, although shortsighted in its prevision, was the

statement made by a considerable number of bankers that the reason for the slowness in our progress was found in the fact that many banks which most desired to get the advantage of the foreign trade and foreign trade financing could not do it through the creation of branches. Their capital and resources were not large enough to warrant the establishment of even one branch abroad, while as for the creation of a series of branches, that was out of the question. Moreover, it was argued, the small banks, and not necessarily the large ones, were those which desired foreign connections. The large banks already had them of a sort, through their system of correspondents, while the smaller banks had no connections abroad but had been in the habit of dealing through the few institutions of all kinds, numbering about seventy-five, which had established actual and direct foreign connections. In order to overcome this difficulty, it was urged, there was immediate necessity for the amendment of the Federal Reserve Act in such a way as to permit the joint establishment of foreign trade banks whose stock should be owned by other banks.

Federal Reserve Act Amended

In framing the Federal Reserve Act, there had been no symptom of opposition to the creation of purely foreign trade banks. That had been omitted from the legislation largely because of the belief that they were not likely to succeed. Both experience and logic were thought to be against any expectation of success on their part, and it was further believed that if they were desired they could be established under existing law through the incorporation of state institutions. So the provision had been omitted from the Federal Reserve Act, in the thought that the act was already entering many new fields of legislation and that if proposals of the kind had no very positive warrant, it would be better to defer them until a later date. The proposal to permit the establishment of foreign

trade banks gained headway during the year 1915 and occasioned little or no opposition. It accordingly came up in Congress during the summer of 1916, a bill designed to amend the Federal Reserve Act being introduced and eventually becoming law on September 7, 1916¹

This legislation now permitted national banks to take out stock up to the amount of 10 per cent of their capitalization, in institutions created to do foreign trade financing whose mission it would be to establish branches abroad and to finance external trade but which could not receive deposits, make loans, or otherwise directly compete with existing national and state institutions. Even this permission, once it was granted, was received with but little enthusiasm and there was no indication of anxiety to take advantage of it. Eventually two or three institutions of minor scope were organized under the terms of the law but it later appeared that similar institutions, and even those in which ex-members of the Board later became interested, preferred to organize under state law. There was really no adequate inducement to the establishment of institutions of the type in question, but, in addition to this it soon appeared that the bank stockholders in such institutions were inclined to suspect one another, or to fear that through some lack of loyalty one or the other of them would be disadvantaged through the knowledge of its transactions or operations gained by the foreign trade bank in which it took stock and to which it agreed to shift presumably much of its foreign business. This factor therefore, operated quite as strongly as any other in retarding the success of the proposed system of foreign trade banks, and while some time naturally elapsed before there was a definite feeling of certainty as to the probable lack of success of the provision it was fairly clear before the end of the year 1916 that not very much could be expected in that direction.

¹ See appendix to this chapter

The Opportunity of the United States

- And yet, from the very beginning of the system, the more farsighted of our legislators and public men, as well as the majority of business men of vision, felt that the war was offering an unexampled opportunity to the United States to make good its hold on the foreign trade of the world and to get a share in the financing of that trade such as had never before been acquired. Unlike the shortsighted bankers who were disposed to let well enough alone and to argue that it was not necessary to incur any risk, inasmuch as conditions were already playing into the hands of Americans, the view was entertained that while the United States might have practically the unimpeded control of the foreign trade situation for the present, the termination of the war would bring about a restoration of competition which would throw us back into pre-war conditions. Indeed, there were observers who held to the opinion that the competitive power of foreign countries would be sharpened and increased as their need was rendered more acute, through the destruction of capital caused by the war, so that in their view there was a probability that at the close of the war American shippers would find it harder than ever to hold their own in world markets.

For all these reasons, there was an undoubted feeling that some action ought to be taken with a view to making it plain to other countries that they could obtain in the United States not only the goods but also the financial assistance which they had secured elsewhere in the days before the war. One exemplification of this view was furnished by the so-called Pan-American Financial Conference which met in Washington during 1915 and whose object it was to afford to South American countries an opportunity to exchange views and ideas and to hold out to them such promise of relief or financial assistance as circumstances would warrant. Much of the discussion at the Conference was naturally of a purely vague description, but there was the hope, and perhaps the belief on the part of

some, that the ultimate result of it would be the practical extension of financing facilities to South America

Secretary McAdoo's Attempt

There being, however no practical movement among American bankers, but on the other hand, a continuation of the general feeling of doubt with regard to South American enterprises that had long existed, the Secretary of the Treasury eventually determined to attempt the extension of the work of the system into foreign countries. This thought on his part was undoubtedly in line with the intent of the Federal Reserve Act. It had been the belief, in framing the Federal Reserve Act, that the extension of our banking facilities into foreign countries would probably require a certain amount of leadership and assistance which was not likely to come from individual bankers themselves, habituated as they had been all their lives to domestic banking with but little touch with, or interest in, foreign operations. So the Federal Reserve Act had provided for the creation of agencies and the appointment of correspondents by reserve banks in foreign markets, with a view to permitting the development of business there, these branches or agencies acting for individual member banks in the United States and undertaking to conduct their transactions there. The act had also afforded a large latitude to the foreign branches or agencies of reserve banks to deal directly with business men, American and others, and to discount their paper, the thought being that in this way they would be able to render an important service in those markets where American banks had no foothold. Secretary McAdoo appreciated this intent on the part of the act and first undertook a study of the question to see how it might be applied.

The following memorandum, prepared at his request, was submitted to him and taken under advisement ²

²Memorandum prepared by the author at the direction of the Secretary of the Treasury.

MEMORANDUM ON FOREIGN AGENCIES AND BRANCHES

POWERS OF RESERVE BANKS

Section 14 of the Federal Reserve Act grants authority to establish foreign agencies as follows

"Every Federal Reserve Bank shall have power

'(e) To establish accounts with other Federal Reserve Banks for exchange purposes and, with the consent of the Federal Reserve Board, to open and maintain banking accounts in foreign countries, appoint correspondents, and establish agencies in such countries wheresoever it may deem best for the purpose of purchasing, selling, and collecting bills of exchange, and to buy and sell with or without its endorsement, through such correspondents or agencies, bills of exchange arising out of actual commercial transactions which have not more than ninety days to run and which bear the signature of two or more responsible parties"

It is evident from the foregoing that there are two separate elements in the authority thus conveyed

- (1) Every Federal Reserve Bank has power to establish the relationships with foreign countries that are indicated but
- (2) These must be "with the consent of the Federal Reserve Board"

In other words, it is intended that the conditions under which foreign business shall be embarked upon shall be determined by the Board and the banks jointly. It would not be appropriate to say that the initiative must come from the banks any more than to make such claim in other cases where the Board has suggested to the banks a specified kind of action. Plainly, the Board may in this case, as in other similar cases, suggest to the banks the initiation of foreign business and then if the suggestion is accepted and the application formally made the Board can give its "consent." It is noteworthy here that once the Board has "consented," the power of the banks to carry on this foreign exchange business is subject only, of course, to the general authority of the Board. There is no specific statement in sub-section (e) that "regulations" must be established for the conduct of foreign business. Elsewhere (last paragraph of Section 13) it is however provided that

"The rediscount of any Federal Reserve Bank of any bills receivable and of domestic and foreign bills of exchange and of acceptances authorized by this Act, shall be subject to such restrictions, limitations, and regulations as may be imposed by the Federal Reserve Board"

This it should be noted applies to "the rediscount" of "foreign bills of exchange" and is, therefore, a limitation upon the foreign operations of Federal reserve banks not as conducted through the agency but upon the application of member banks at home. Further, in Section 14,

the general open market power given to Federal Reserve Banks is as follows

'Any Federal Reserve Bank may under rules and regulations prescribed by the Federal Reserve Board, purchase and sell in the open market at home or abroad, either from or to domestic or foreign banks, firms, corporations or individuals, cable transfers and bankers' acceptances and bills of exchange or the funds and maturities by this Act made eligible for rediscount with or without the endorsement of a member bank."

This power is independent of the broad general authority quoted at the beginning of this section and is narrower than it. It relates simply to open market operations in foreign bills of exchange and not to the conduct of foreign business expressly. The latter is dealt with in the paragraph first quoted.

Summing up, therefore, we may say that exceptionally broad powers to embark in foreign business have been given to Federal Reserve Banks and that exceptionally little regulation has been imposed upon these operations under the Act always provided that the paper bought arises 'out of actual commercial transactions which have not more than ninety days to run and bears the signature of two or more responsible parties. The latter class of paper as is well known constitutes the staple commercial paper of foreign countries and there is a much larger market in it than exists in the United States.

BRANCHES VERSUS AGENCIES

An inspection of the foregoing provision shows that three classes of power are conveyed to Federal Reserve Banks in connection with foreign business. They are as follows:

- (1) To maintain banking accounts in foreign countries—Section 14—Sub-section (e)
- (2) To appoint correspondents in foreign countries. *Ibid*
- (3) To establish agencies in foreign countries. *Ibid*

The Act is specific as to what may be done in the way of business and it is perfectly plain therefore that the three practical means set forth above are simply modes of carrying on this business. That is to say the banks may buy and sell the classes of paper indicated in the Act growing out of foreign trade and they may handle the business either by establishing accounts abroad or by appointing correspondents or by creating agencies. The fact that the word 'branches' is nowhere used has by some been employed as a basis of argument that the broad distinction was drawn by framers of the Act between the idea of the branch and the idea of the agency and the character of the business to be done by it. There is no basis for any such assump-

tion When the Act was in process of preparation no provision was made for domestic branches up to the very last moment, but the provision for foreign business existed from the start. The term "agency" was employed as indicating an office of the Reserve Bank which was not necessarily vested with any particular segregated capital and whose operations did not bear any distinct relation to the operations of the parent bank. This idea can be better understood by noting the provision of Section 25 wherein National banks are given power to establish branches and it is required that they set apart a specified proportion of the capital and keep independent books. The term "agency" is used in connection with the Federal Reserve Banks as differentiating from the term "branch" as used by National banks simply in this way—that the agency is not an independent institution separately organized with a reasonable capital and with a limit to its operations. When the provision as to branches of Federal Reserve Banks was finally introduced into the law its character was distinctly perceived, the branches here spoken of being institutions with separate Boards of Directors and separate organization.

Summing up this point, therefore, it may be said that the use of the term "agency" as applied by a foreign office of a Federal Reserve Bank in no respect limits its possibilities but if anything broadens them as compared with the word "branch." The "agency" is a place at which the parent bank may do anything through its agent that it could do if itself physically present there with its full resources and capital. In any event, the kind and class of business to be done is fully set forth in the Act.

CONDITIONS OF ESTABLISHMENT OF BRANCHES

This subject was fully considered by the preliminary Committee on Organization and the subject was worked out substantially as follows:

The first point which, it is believed, calls for careful consideration is the number of branches of reserve banks which shall be independent of one another. Plainly the provisions of the law are such that if the Reserve Board should approve of such a course each and every one of the several reserve banks might establish independent branches in foreign centers. The conceivable result of such action would be the establishment of a number of branches, one to each reserve bank, equal to the number of reserve banks, in every important foreign center. This, it is believed, would be unwise. From the standpoint of the foreigner the reserve system should be organized as a unit, while

in controlling the flow of specie to and from the United States it should act as a unit with a single and uniform policy and without competition within itself. These requirements could be fulfilled best, it is believed, by requiring the reserve banks to join in designating a common agent or to join in creating a joint branch at each foreign center where it is believed that such representation is needful or desired. If it should appear that some of the reserve banks do not care to have such representation abroad then co-operation could be waived, the whole matter being placed upon a voluntary basis. But if they find that they want such representation then they should be required to co-operate in establishing and bearing the expense of the branch existing at the point where the representation is desired. This naturally necessitates a plan of dividing the expenses of the branches or agencies abroad between the Federal reserve banks. It is recommended that the following plan shall be in substance followed:

1 Whenever a Federal reserve bank desires to establish a branch or agency in a foreign country it shall make application to the Federal Reserve Board for permission to do so and in case such permission is granted it shall be allowed to establish the branch or agency under conditions of organization conforming to the principles laid down in the general provisions that may be adopted with regard to branches.

2 If any other reserve bank should subsequently desire to secure representation in the same place at which such branch or agency may already exist it shall be required to select the same agent, or if a branch has actually been established it shall be permitted to join in the operation of the branch, bearing a share of the expense dependent upon the percentage of total operations undertaken for its account as compared with the aggregate operations of the branch.

3 The personnel of the branch organization shall continue as first established by the reserve bank which created the branch but as places fall vacant they shall be filled upon the nomination of the reserve bank subsequently joining in the operation of the branch in a proportion corresponding to its payment of expenses.

4 Should other reserve banks desire to join in the operations of the branch they may do so upon a basis of division of expenses based upon the principles already laid down above.

5 Should the Federal reserve banks subsequently desiring representation (after the establishment of the branch by one such bank) prefer to have the branch already existing act as agent for them they may do so and in that event the reserve bank or banks actually co-operating in the conduct of the branch shall charge for their services a sum to be determined at the end of each half year and dependent upon the proportion borne by the operations of the bank or banks designating the branch as agent, to the total operations of such branch.

6 Whenever a foreign branch is organized a specified sum shall be assigned to it as a basis for its operations. Other reserve banks which subsequently participate in the operation of

the branch shall assign to it a sum of working capital to be determined in the same way

7 In the event that several reserve banks desire at the outset to join in the establishment of a branch at a designated foreign center, the total working capital to be set apart will be determined as above indicated and shall be divided among the several reserve banks in proportion to their capitalization

8 The accounting records of each such foreign branch shall be the same as those prescribed for domestic branches, except that the reserve banks participating in the operation of the branch shall be regarded as joint partners

AN ALTERNATIVE METHOD

As has already been noted the Federal Reserve Act provides for the maintaining of banking accounts in foreign countries and for the appointment of correspondents as well as for the creation of agencies. If desired, the banks need not be put to the expense of establishing agencies at the present time but they may be merely authorized to appoint correspondents. This would mean that they would select suitable institutions in the various foreign centers (selecting banks of unquestioned character and responsibility), and place their funds with these institutions. The cost of this mode of procedure would be small, it depending almost entirely upon what the correspondents thus named were qualified to do. While, therefore, the creation of agencies is desirable, it is recognized that to establish many of them at the start would be costly and that the beginning may perfectly well be made through the selection of correspondents and the maintenance of banking accounts with these correspondents in such capitals or financial centers as it is desired to reach.

CHARACTER OF BUSINESS

The question must, of course, be definitely answered

What would these correspondents or agents do?

The Act states that their function should be that of "purchasing, selling and collecting bills of exchange," also that they would "buy and sell bills of exchange arising out of actual commercial transactions." Here are two distinct classes of business recognized as such by the framers of the Federal Reserve Act. The first is that of "purchasing, selling and collecting," the manifest intent being that this should be done on behalf of or for the "member bank," that is to say, a member bank in—let us say—Moline, Illinois, which had been requested by a local agricultural implement company to collect a draft, drawn at ninety days, on a concern, say, in France, which had purchased agricultural implements, would place this draft

in the hands of the Federal Reserve Bank of the district which would then collect it through its French correspondent or agency, possibly discounting it in the meantime for the benefit of the member bank and its customer or possibly merely undertaking the collection service. This is the kind of work which some member banks are now exceedingly anxious to have the Federal Reserve Banks undertake and it involves no risk whatever when properly conducted. The second kind of business, as already seen, is that of buying and selling bills of exchange of certain kinds in the countries where the agencies are located—that is to say, it is contemplated that the agencies shall undertake foreign exchange operations and accumulate bills when exchange is likely to be wanted in the near future or dispose of them as the case may be. This is a highly profitable branch of banking and it was the opinion of competent men while the Act was in progress of preparation, that some at least of the Federal Reserve Banks would easily maintain themselves by this branch of business.

OBJECTIONS TO FOREIGN BUSINESS

The following objections are now made to having the Federal Reserve Banks engage in any foreign business whatever either through the purchase of foreign bills of exchange at home or through operations abroad.

(1) The establishment of foreign agencies would involve expense.

This objection does not hold if the banks merely enter the market for foreign exchange and foreign bills in this country. Neither does it hold if the entry into the foreign market is made through the appointment of 'correspondents'.

(2) There is grave danger in embarking on any foreign exchange business today, because of the doubtful conditions created by the war.

This does not hold good in many of the neutral markets of the world and probably does not hold good in markets in the belligerent countries if the operations are carefully conducted there—certainly this contention has in any case very limited scope.

(3) It is not desirable to have the funds of Federal Reserve Banks "tied up" in foreign bills at a time when they are likely to be wanted for development of our own business and for the maintenance of domestic industries.

Whatever force there might be in this argument largely disappears in view of the fact that the broadening of the acceptance regulations

by the Board now enables bills representing even very long term export operations to be discounted. It is true that under the acceptance regulations the acceptance or endorsement of both of American banks is obtained, but this is more important technically than it is actually. In view of the action taken on the acceptance regulations, the argument against tying up the funds of American banks in the foreign market very largely loses such force as it would have had, perhaps, if it be assumed that the Board will maintain a general oversight over all the operations of Federal Banks with a view to preventing any given branch of business from being over-developed.

Summing up, the argument is, therefore, strong at the present time in favor of having Federal Reserve Banks engage in foreign trade operations of every description, and the more so in view of the following considerations

- (1) Desire to extend our trade to neutral markets
- (2) Desire to extend our export trade in all markets

"OPEN MARKET" PROBLEM

The foreign exchange question has a very close relationship to the general open market proposition. As yet the Board has not adopted any regulations relating to open market purchases by Federal Reserve Banks. The prevailing opinion in the Board undoubtedly is that, if open market operations be initiated they must be confined to "bills of exchange" (and of course acceptances) inasmuch as "notes" originally provided for in the open market section were omitted. Such "bills of exchange" may be either domestic or foreign bills. In all events they are two-name commercial paper. To embark upon foreign operations means essentially to undertake open market operations on one side only. . . . the foreign side of the business and not on the other. It would seem to be a singular dilemma in which those who oppose open market operations are placed, since they contend

- (1) That there is danger in foreign exchange (open market operations) because of the uncertainty of payment abroad, due to the war, while they also contend
- (2) That there is grave danger of failure of payment at home due to the inability of makers to liquidate their paper

The logical conclusion would seem to be that there is no paper safe enough for a Federal Reserve Bank, except that which comes to it through a member bank, and that even this latter class of paper is not satisfactory, even with the endorsement of a member bank, if it is distinctively the paper of a foreign buyer. This contention goes too far and seems to prove too much. It is a fact that Federal Reserve

Banks are now to be called upon to finance export trade through the rediscount of paper of those who are engaged in it. That being the case the argument against their engaging in it themselves disappears. It is also true that if open market operations in foreign trade are undertaken the logic of the case strongly demands open market operations at home today—that is the purchase of domestic bills of exchange in the open market. The open market operations in foreign bills will undoubtedly be obnoxious to the large member banks in the cities where foreign exchange is a profitable field of operation. The open market operations in domestic bills will be obnoxious not only in the cities but in the smaller towns where they furnish a satisfactory investment to member banks.

Summed down the real question about the undertaking of foreign exchange operations is the same as that connected with the open market purchase of domestic bills at home—whether national banks will be willing to 'stand for' the proposal or not. Assuming that the foreign operations are undertaken with sufficient care, prudence and banking skill, there is every reason for entering upon them at an early date and the same may be said of domestic bills of exchange, the controlling reason in both cases being the same.

McAdoo's Plan to Establish Latin-American Branches

The conclusion of the Secretary was to the effect that it would be well to make our relations with South America much more practical than heretofore, by undertaking the establishment of some branches of federal reserve banks in some South American countries. He was of the opinion that such branches could successfully be introduced without much risk, due to the fact that a good deal of the trade with South America could be obtained on a dollar basis, while where it was not on the dollar basis it would be easy to "cover" by the usual methods the commitments in exchange that might be undertaken. Such a step, he thought, would strengthen the reserve system, assist our business men and bankers to get a strong hold on the South American trade, confirm a beginning which had already been made by American banks in the establishment of branches, and generally lay the foundation of a broad extension of our operations after the close of the war. Even if it be true that the idea

was not thoroughly worked out by the Secretary of the Treasury and that, as was unquestionably the case, much would have to be done to make his notion practicable, it should be definitely said that Secretary McAdoo's effort was the only attempt of the kind made by the government to confirm our banking relations to foreign countries and to establish a suitable underlying foundation for future good relations. Secretary McAdoo made known his purpose in a statement taken from a report to the President, which he made public and in which he announced the intent of the government to see to the establishment of such branches. This statement was as follows:

The Federal reserve act has so consolidated and organized our credit resources that our bankers are, for the first time in our history, able to engage in world-wide financial operations. We now have the available resources. It is merely a question of their intelligent use.

The first step should be the establishment of the necessary branches or agencies in the leading cities of all of the countries of South and Central America by a bank or banks having the necessary resources to take the business that is open to them. One of our largest banks has had the enterprise to establish branches in some of the largest cities in South America, but manifestly the resources of a single bank or of several of our largest banks are insufficient to meet the demands of the situation as it now exists and as it will develop in the future. What is needed is the use of the consolidated banking power of the United States applied through agencies established in the leading cities of Latin America.

The Federal reserve act has supplied the necessary authority, and it only remains for the Federal reserve banks, with the approval of the Federal Reserve Board, to make practical use of that power. Section 14 (paragraph e) of said act gives every Federal reserve bank the right—

"To establish accounts with other Federal reserve banks for exchange purposes and, with the consent of the Federal Reserve Board, to open and maintain banking accounts in foreign countries, appoint correspondents, and establish agencies in such countries wheresoever it may deem best for the purpose of purchasing, selling, and collecting bills of exchange, and to buy and sell with or without its indorsement, through such correspondents or agencies, bills of exchange arising out of actual commercial transactions which have not more than ninety days to run and which bear the signature of two or more responsible parties."

In addition to these powers, the Federal reserve banks may 'under rules and regulations prescribed by the Federal Reserve Board purchase and sell in the open market, at home or abroad either from or to domestic or foreign banks, firms, corporations or individuals cable transfers and bankers acceptances and bills of exchange of the kinds and maturities by this act made eligible for rediscount with or without the indorsement of a member bank,' and may 'deal in gold coin and bullion at home or abroad make loans thereon' etc and 'buy and sell at home or abroad bonds and notes of the United States,' etc Enlargement of these powers would be desirable to increase the usefulness of foreign agencies of Federal reserve banks and it is probable that the Congress would grant such enlarged powers upon good cause shown

The 12 Federal reserve banks could, with the consent of the Federal Reserve Board establish joint agencies in each of the countries of Latin America their interest in such agencies to be in proportion to the capital stock and surplus of each participating Federal reserve bank The combined capital stock and resources of our Federal reserve banks, utilized in this way for the extension and promotion of our foreign commerce would give them unrivaled financial power They could maintain themselves in foreign fields in competition with the world and perform a service of incalculable value to the American people

During the Pan American Financial Conference the suggestion was made by some of our leading bankers that the national-bank act might be amended so as to permit a number of the national banks to become stockholders in an independent bank organized for the purpose of doing business in foreign countries This plan, even if it were not open to objection would be manifestly inferior to the agency or the combined Federal reserve banks The Federal reserve banks comprise in their membership every national bank in the United States as well as a number of our leading State banks and trust companies They constitute a financial organization of unequalled strength and their operations in foreign countries will be for the common benefit of all of the national banks, State banks and trust companies composing the Federal reserve system These agencies in foreign countries could, in addition to their banking business, render a great service to American business men and bankers by furnishing credit reports and general information about trade and finance in the various countries in which they operate

The power of the Federal reserve banks to establish such joint agencies in foreign countries, with the consent of the Federal Reserve

Board, appears to be beyond question. The initiative rests with the Federal reserve banks. While they can not be compelled to establish such agencies, I believe that upon careful study of the situation and with the encouragement of the Federal Reserve Board they will be prompted to take this important step.

The establishment of Federal reserve agencies will not prevent the member banks from carrying on and enlarging the business they are now doing in foreign countries. It is gratifying to note that many of our national banks and trust companies are showing commendable enterprise in supplying credits to Latin America.

This statement had not been made known to the Federal Reserve Board and the publication of it caused some irritation. Entirely apart from this temporary ill-feeling, however, there was a very strong element in the Board which did not want to see the system go into foreign trade no matter how safely or securely the work might be done. The Federal Advisory Council had already announced itself as hostile to any incursions of the reserve banks into the field of foreign financing or exchange, and their views had been communicated to the Federal Reserve Board not only in an official way but also unofficially. Accordingly the Board, acting almost as a unit, undertook the consideration of the problem which had been thus forced upon its attention by Secretary McAdoo.

Attitude of the Board

After a series of discussions of the whole foreign situation, the Board came to the conclusion that the time was not ripe for any attempt to develop the reserve system abroad, that this field should be left to the activity of member banks, and that anything that might interfere with them would be undesirable. Having reached this conclusion, the question how it should be made known came up for consideration and two opposing views made themselves apparent, the one to the effect that it should be communicated only to the Secretary of the Treasury, the other that it should be given to the public. The latter view

eventually triumphed and accordingly a press statement was issued on October 12 in the following language

At the meeting of the Federal Reserve Board this morning there came up for consideration and discussion the report of a committee of the Board to whom had been referred the subject of banking relations with the South American and Central American countries as recommended by the Secretary of the Treasury in correspondence transmitted to the Board October 6

The committee report expressed the view that Federal Reserve Banks, being the custodians of the reserve money of the member banks, should not be permitted to do pioneer work in Latin American countries granting credit facilities which would lead to a lockup of reserve money in loans which, in most of the cases, would be subject to wide fluctuations of foreign exchange Secretary McAdoo stated that his recommendations about joint agencies for Federal Reserve Banks did not contemplate this character of operation

The report reminded the Board of the policy pursued for generations by the large government banks of Europe, which do not go into foreign fields except that they hold as secondary reserves foreign bills on the most important European countries where large discount markets exist and where the gold standard is established beyond question In those countries these government banks maintain correspondents, and the committee believes that when normal conditions shall have been restored in Europe joint agencies or correspondents could be used to good advantage there The committee also called attention to the fact that England, Germany, and France have established independent banks or branch banks of deposit banks in Latin American countries to do pioneer work and that the United States should pursue the same course, inasmuch as it is necessary for banks going into this field to have the widest possible range of activity in order to be able to compete with the local banks and the branches of the foreign banks already established in these fields Federal Reserve Banks being properly restricted to certain transactions, and such as may not interfere with the absolute liquidity of their condition could not compete successfully in this respect whereas it should be their function to do all in their power to assist American banks which enter the Latin American field

The committee favored and the Board and Secretary McAdoo concurred in, suggesting an amendment of the Federal Reserve Act which would enable American member banks to cooperate for the purpose of jointly owning and operating foreign banks The contribution of the Federal Reserve Banks in this development in Latin America would

primarily consist in providing conditions so favorable for American acceptances that the American banks willing to offer facilities there will be materially assisted in meeting the European rates which, at the present time and probably for some time to come, will compare unfavorably with the American discount rate

Wherever the Federal Reserve Banks can help in the development of American banking by establishing direct connections in Latin American countries for the purpose of facilitating discount operations of this kind it will be, in the opinion of the committee, the proper function of Federal Reserve Banks to do so

The committee took the position that American banks entering this field ought to be permitted to develop the opportunities first, but that in trade centers where American banks are not established it might be proper for the Federal Reserve Banks to appoint joint correspondents or agents in order to facilitate the development of American acceptances in such places

The Board expressed itself as in entire agreement with these views of the committee. The Secretary of the Treasury, who was present at the meeting, announced himself as also in full accord. The Secretary stated that he agreed with the Board that the resources of the Federal Reserve Banks should not be invested in nonliquid loans in Latin American countries, and that he was in hearty accord with any measure that the Board might ultimately evolve which would have as a result the development of American banking in Latin American countries

The committee hopes to make its final report early in November, after recommendations shall have been received from the conference of Governors of Federal Reserve Banks which is to take place at Minneapolis on October 20 and the conference of Federal Reserve Agents which is to take place in Washington on November 4

The action thus taken by the Board was in the nature of a direct rebuke to the Secretary of the Treasury and was undoubtedly received in that way by him. It contributed quite materially to the coldness which had already begun to develop between him and the Federal Reserve Board, and although he from time to time considered further the question as to what ought to be done in the direction of developing the foreign service of federal reserve banks, he had not reached any conclusion on the matter when this country entered the war. The problem had been allowed to drop, and a very considerable

opposition to any action had developed among the banks of the country. Not only the Federal Advisory Council, but the larger banks interested in the foreign exchange business had begun to express themselves with great positiveness against any kind of intervention. So, when the time came for the establishment of an agency relationship with the Bank of England, there was difficulty in carrying it through to successful termination, and even with the utmost care on the part of the Board and the banks the arrangement was not finally consummated without the unfortunate episode which has been briefly reviewed in Chapter XLVII above. So remote was the agency relationship with the Bank of England then established, from any real foreign activity, that it falls, as already seen, more logically under the head of special war arrangements than under any relating to the development of the federal reserve system. The arrangement with the Bank of England already described, had contained a stipulation that neither banking system was to operate in the bill market of the other during the continuance of the war.

Other Foreign Agency Problems

Other arrangements of the same general sort were perfected during the year 1917, but none of them amounted to more than an arrangement of convenience largely due to war necessities. The only one that might have developed into a genuine foreign agency or foreign correspondent relationship that with the Philippine National Bank, was rendered practically nugatory for other reasons. Thus, with the actual entry of the United States into war, it might fairly be said that the federal reserve system had, up to that time, played no part in foreign trade financing worthy of the name, and that it had not come to occupy a position of any influence whatever in connection with exchange rates. Our advent upon the scene of the war naturally gave rise to a serious question whether the time had not come for a totally different policy. Secretary McAdoo, as else-

where seen, had obtained the services of a financial advisor to whom had been allotted very largely the function of keeping in touch with foreign conditions and advising the Secretary of the relationship between our banking system and those of other countries. This function was afterward greatly broadened, but at the beginning was of primary importance in connection with the exchange situation. There were many ways in which the relation of the federal reserve system to foreign conditions presented itself during the early days of our participation in the war. One was the obvious question whether some important service would not be called for in transferring and paying the great sums which we were advancing to foreign governments, but this was largely thrown into the background by the agreement speedily entered into for the spending of the sums so advanced chiefly in the United States. Another question related to the payment of our troops abroad, but even this did not assume an important phase for a good many months, since the transfer of troops did not begin in great numbers for some time.

"Pegging" Exchange

More important and more immediate was the question whether our foreign loan policy could be regarded as committing us to any definite plan or policy with respect to the "pegging" of exchange. Great Britain had already instituted a system whereby her pound sterling was "pegged" in its relation to the dollar at 4 76. This had been done from a variety of considerations. It was desirable from her standpoint that the pound sterling should command as many dollars as possible so long as Great Britain was a heavy buyer of our products. It was also a matter of financial prestige to keep the pound sterling on a high basis of quotation. Great Britain's financial operations in the American market were also undoubtedly facilitated by favorable exchange quotations. All told, therefore, it was possible for her to make out a substantial

case in favor of the pegging of sterling, no matter what academic economists might think about the ultimate wisdom of such a course. What was true of sterling was also true of francs and lire, and a modified system of pegging as applied to those currencies logically followed the plan that had been developed to protect sterling.

When the United States entered the war there was apparently no understanding as to any such question of international currency management, nor was there anything on the subject to be found in our early war bond acts. Treasury authorities undoubtedly supposed that Great Britain would continue the process of pegging. They were surprised, therefore, to obtain an informal notification that it would be difficult for Great Britain to continue this phase of her financial activity and that she supposed the United States would be prepared to sustain it. Essentially this was reducible to the question whether portions of the money which we advanced as the result of our Liberty loans might with our consent be spent in maintaining sterling at 476¹.

The Problem of Exchange "Pegging"

As to this a number of considerations at once came to mind. True, the funds spent in London exchange would technically be expended in the United States, but there was a question whether such "pegging" of exchange did not really result in making the American taxpayer accept much less for his own goods than he would had sterling been left to follow its own course. The question whether the pegging process was really economical and wise, and whether it would not, after its ultimate suspension, react upon conditions in such a way as to produce real unsoundness, was also well worthy of consideration. Yet the question naturally presented itself whether if the United States was to assist in pegging sterling exchange, it ought not to

¹ The sum invested by Great Britain in the "pegging" process during the year preceding our entry into the war was stated as \$1,100,000,000.

undertake to do it through the federal reserve system—that is to say, whether it might not more cheaply and more successfully maintain a certain equivalence between the pound sterling and the dollar through satisfactory operations conducted by reserve banks in the British market, and of course in the American market as well. The subject was evidently one that could not be deferred very long, particularly in view of the insistence of the British authorities for some information on the subject.

Closely allied with it was undoubtedly the question whether the United States should or should not place an embargo on gold. The two things, exchange pegging and gold embargo, naturally went together and constituted elements in a single policy. A conclusion on one in a certain sense implied a conclusion on the other. Of the two the gold question was apparently the easier to solve, although in a sense it was a derivative of the exchange problem. Congress had given the President full powers to do practically anything that he pleased in the financial management of the war, subject of course to the general restrictions of the War Bond Act of 1917. The situation was therefore before the President for careful consideration, and it was deemed wise to refer the matter to various officials and individuals for their opinion. This resulted in a very extensive discussion of the whole subject, and eventually the gold problem was referred to the Federal Reserve Board for an opinion, which was adverse to the idea of embargo. The salient features of the Board's letter on this subject were of such unquestionable soundness and cogency that they may be presented at some length as follows:

July 10, 1917

Dear Mr. Secretary

At its meeting this morning the Federal Reserve Board considered the several topics which we discussed in your office before the meeting, and in accordance with your request, I submit herewith, in behalf of the Board, an outline of its views and recommendations.

Before entering into a discussion of the topics severally, it is pro-

per to state that the Board is unanimous in its opinion that it would be detrimental to the credit of the United States to place an embargo upon gold exports. The Board feels that the United States, with reference to shipments of gold abroad might very well proceed along practically the same lines as England. The British have not hesitated to make great sacrifices in order to live up to their obligations to pay external debts in gold. It is true that this policy has at times been maintained more as a matter of form than of fact but at the end of the war England will naturally proclaim the fact that she maintained her gold standard throughout the great conflict while in the United States should place an embargo upon shipments of gold statements would be made to our discredit that we did not carry out our legal obligations, by paying our debts in gold. The Board however sees no objection to putting certain obstacles in the way of shipping gold whenever such shipments are found to be against the interests of this country and of its fellow participants in the war. This policy has been adopted by Great Britain, and the Board recommends that it be pursued by our Government.

It appears to the Board that the Secretary of the Treasury is in position to control marine insurance to such an extent that gold exports can be prevented or materially reduced by the refusal to insure or by granting insurance only at rates which would be in effect prohibitive. The Board wishes to point out that the machinery of the Federal Reserve Banks could be used to great advantage in this connection and would suggest that the Secretary of the Treasury consider making a statement that no shipments of gold will be insured except such as have been scrutinized in advance by the Federal Reserve Board acting through the Federal Reserve Banks of the respective districts. This course would enable the Government to analyze in each case the purpose of the proposed shipment and to decide whether the underlying transaction upon which the gold shipment is based should be encouraged or discouraged in the present circumstances. The records that would be kept of the applications and permits for shipment would, in the opinion of the Board, prove to be very valuable. There is no difference of opinion that the legitimate debts of the United States and of its importers must be settled in a manner satisfactory to creditors, and if no other means of paying debts can be found they must be paid in gold. But it seems to the Board that the power should be vested in or assumed by some governmental agency of determining what importations should be encouraged at this time.

and what importations should be frowned upon, by an embargo if necessary, following in this way, the analogy of the embargo which has been placed upon certain exportations

The Federal Reserve Board, through the Federal Reserve Banks, can report if desired upon the transactions underlying demands for shipments of gold abroad, but it would be necessary that the banks receive definite information as to the policy that may be decided upon in dealing with the various commodities and countries. In discussing the topics from this point of view, the Board would say, with respect to

(1) Gold Exports to India

That there is no objection to shipments of such reasonable amounts of gold as may be necessary in payment of our imports, it being understood that these imports are necessities, such as jute, the Board having been informed that gold shipments to India will be made to some bank under British supervision which will keep the gold in its vaults and not let it go into circulation and be hoarded by the native population

(2) Shipments to Japan

It appears that at present Japan controls the trade in silk. The national policy as to importations of silk is a matter for the Government to decide. Should any attempt to restrict these importations be deemed inexpedient, the Board would point out that American banks ought not to be placed in a position of refusing to make gold shipments, while the agents of foreign banking institutions are making such shipments

(3) Shipments of Gold to Spain

The commodities which are imported from Spain against which payment of gold must be made are principally olive oil and cork. Should the Government wish to discourage importations of these commodities, and prefer not to place an embargo upon their importation, it could throw an obstacle in the way by increasing the price to consumers by refusing to insure shipments of gold to Spain. It appears that American gold is at a heavy discount in Spain, while French gold is taken at par and British gold at a slight discount. In any case, it seems that our Government might bring pressure to bear on the Spanish Government to have our gold accepted in Spain at its bullion value. It should be remembered, however, that a concession of this kind on the part of Spain or of the Bank of Spain would tend to lower prices of articles imported from Spain, thereby increasing importations

and making necessary larger shipments of gold in payment. Exporting and importing operations between this country and Spain result in a trade balance in our favor, and the anomaly that the United States must be constantly remitting gold to Spain to be taken there at a discount is accounted for by the fact that England and France are heavy purchasers of goods from Spain but that they will not ship gold to that country. They have permitted their exchange in Spain to go to heavy discount while they have kept dollar exchange in New York at par or better, the premium on dollar exchange in London at present being about 2% above normal gold parity. The Board is inclined to the opinion that possibly too much has been made of the Spanish exchange situation for the credit of the United States is too broad and too well established to be affected by any artificial exchange condition that exists in Spain. It is true that because of these conditions our importers are obliged to pay more for commodities purchased in Spain, but it is equally true that the higher rate for pesetas must indirectly and to a larger degree affect our export.

(4) Melting of British and French Gold Coins into Bars at the Assay Office

The Board is of the opinion that under present conditions it is a wasteful practice to melt British and French gold coins which frequently can be disposed of to advantage as foreign gold. The Treasury is permitted by law to accept foreign gold coins up to a certain percentage of the total amount of gold certificates outstanding, and Federal Reserve Banks may take them and count them as reserve with their American eagles gold certificates or gold bars, foreign coins being accounted for at their bullion value. The Board has counsel's opinion to the effect that there is no doubt as to the legal powers of the Federal Reserve Banks to do this.

(5) Discontinuance of Issue of Gold Certificates in Denominations Less Than Fifty Dollars

Since the Act of June 21, 1917, amending the Federal Reserve Act has been placed upon the statute books and Federal Reserve Banks are authorized to issue Federal Reserve notes in exchange for gold, it appears to the Board to be most desirable that Federal reserve Banks be placed in a position where they can issue and circulate freely five, ten and twenty dollar Federal reserve notes. The Board strongly urges that the Secretary of the Treasury give directions that as far as possible the issue of gold certificates in denominations of less than fifty dollars, be discontinued.

The foregoing is respectfully submitted in behalf of the Federal Reserve Board

Respectfully yours,
W P G HARDING,
Governor

Gold Embargo Declared

In spite of this argument, Secretary McAdoo, acting for the President, promptly declared an embargo on gold and shortly turned over to the Federal Reserve Board the duty of enforcing this policy. The Board in turn transferred it to a special "Gold Export Committee" which took charge of the entire work from that time forward, its acts being ratified by the Board pro forma from day to day or from week to week.⁴ Within a few days thereafter, decision was arrived at to put into effect a control of foreign exchange, and the development of foreign exchange regulations was placed in the hands of the Federal Reserve Bank of New York. This bank suggested to the Board the establishment of a special foreign exchange control office in New York which presumably would report regularly to the Board for approval of its acts, all of which were undertaken in the name of the Board itself. As a matter of fact, the regulations proved troublesome and difficult to work out and they did not get fully into effect until after the new year (1918). Meanwhile a kind of informal control was exercised over exchange operations, and after the ratification of the new regulations this control became more and more severe and positive.

The Board, however, paid but little attention to it and was apparently content to give a general ratification to the acts of the foreign exchange office or division. When such acts were reported to it, it seldom gave them detailed discussion. Thus a great system of control of international relations was built up, but it was built up without direct development of any banking organization to deal with it or to supply exchange. It was

⁴ This Committee consisted of three members of the Board and one representative of the Treasury, with the Secretary of the Board as secretary.

developed on the basis of governmental oversight and control through regulation—an arbitrary and artificial control. Out of such a situation some difficulties were inevitably to be expected to develop, and it was not long before they made their appearance.

One external symptom of such difficulties was found in the development of premiums on foreign currencies, as well as in lack of ability to obtain the exchange that was needed in order to make such remittances to such countries, and dissatisfaction among the nations themselves because of their inability to draw gold from the United States, notwithstanding that they might have a substantial balance of trade here. It was easy enough to overcome such objections on the part of belligerents, but the situation was different in connection with our trade with neutrals. The operations of the Board's foreign exchange control plan, like all such systems, tended to aggravate the underlying disturbance of conditions. No government administrator is ever able to discriminate very carefully between worthy and unworthy applications for permission to ship gold or to engage in foreign transactions. The business is too technical and requires too large a knowledge of detail and of private affairs to permit such judgment to be accurate. Altogether, therefore, the general conditions were such as to produce profound disturbances, and the year 1918 was not far advanced before the reserve system was obliged to go into the business of obtaining exchange and supplying it to member banks in order that they might meet the needs of their customers.

Quantities of rupee exchange were obtained from the British government, parceled out among the reserve banks, and by them sold to their customers at high prices, the reserve banks making a substantial profit since they thought it necessary to sell the rupee at a figure corresponding roughly to what was supposed to be market value, in order that there might be no undue preference for those who were thus served. Arrangements were concluded with Argentina and with one or two

other countries, whereby their representatives in the United States authorized transfers on the books of the Federal Reserve Bank of New York which resulted in the establishment of a kind of gold trust fund representing the balance due Argentina which the reserve system undertook to release (with the consent of the Treasury) within a specified period after the close of the war. Canada, which found herself greatly embarrassed by being cut off from American markets and found her rates of exchange suffering seriously, was allowed twenty-five million dollars of gold for export and the promise of as much more, should her situation require it, during the crop-moving season of 1918. Canadian banks were invited to enter the federal reserve system as members and thus to tie their financial future even more closely to that of the United States, but deemed it inexpedient to propose such a thing in the event of unquestionable adverse Canadian public opinion.

To review the entire list of negotiations and special arrangements, as well as to trace the course of exchange and to illustrate the intricate ways of relieving the embarrassments that had grown up by reason of the gold embargo and the exchange control system, would require very detailed treatment. Enough has, however, been said to give a general idea of the problems by which the federal reserve system was confronted and of the way in which they were met. They were merely the temporary outgrowths of the war and belong more truly to the financial history of the struggle than to any review of banking experience. One phase of the foreign relationships of the reserve system must, nevertheless, be noted with some degree of care since it directly and profoundly affected the currency situation. This was the negotiations which led to the so-called Pittman Act.

The Pittman Act

Comparatively early in the year 1918, Great Britain had found a growing condition of embarrassment in the Indian

currency system, due to the fact that a tendency to hoard specie, obtained by the presentation of notes had set in. The specie stock behind the notes had become so greatly reduced that there was at least a possibility of suspension, the Indian government finding itself obliged to contemplate ceasing the conversion of the notes into silver. With the existing unrest and dissatisfaction which prevailed in India, where many long-suppressed elements of disorder seemed to be struggling to the surface, such a development would have been considered most dangerous. It was therefore determined to make every effort to obtain a supply of silver elsewhere, but the world's markets had been swept fairly bare of the metal, due to the hoarding and other unusual conditions which accompanied the war.

Undoubtedly the greatest visible supply of available coin was to be found in the Treasury Department of the United States, where at the time an aggregate of silver was being held behind certificates and other public currency in the amount of about four hundred million dollars. This silver was, of course a trust fund whose representatives, the silver certificates, were in circulation or in the hands of the banks. It could only be taken or released, therefore, through the acquirement of the silver certificates. A good many of these could, of course, be obtained without delay, and the suggestion was therefore made to the Treasury authorities that they should retire these certificates, give up the silver to Great Britain, and permit its export.

The proposition, however, involved several serious elements of difficulty. Silver mine-owning interests, always powerful in Congress by reason of their control of legislators representing western states, did not take kindly to the idea of seeing an important source of foreign demand cut off. Inflationary interests, likewise strong in Congress, could not be expected to consent to what they would call "contraction of the currency" due to the withdrawal of silver certificates. The Treasury was not willing openly to meet these two interests upon the ground of public necessity, nor, on the whole, was it deemed wise to have

the country at large too closely informed of the reasons for the exportation of the silver. It was determined, therefore, to negotiate with the silver mine interests and the inflation senators and representatives, a plan whereby the silver certificates would be retired as rapidly as need be, the silver behind them would be released and turned over to Great Britain which would give her obligations in exchange, and to fill the "gap" federal reserve banks would issue federal reserve bank notes on the strength of the circulation bonds which they had already purchased from member banks, and upon the strength of other bonds to be acquired by them as needed.

The plan, of course, nominally required the assent of the Federal Reserve Board through whom presumably the representation would have been made to the federal reserve banks and, so far as necessary, to member banks. The matter was brought up before the Board by a representative of the Treasury Department who was then acting as a member of the Gold Export Committee—Mr. Albert Strauss of New York, afterward to become a member of the Federal Reserve Board. Mr. Strauss explained the result of the negotiations with the silver mine interests and the other legislators affected, and the question was taken under advisement by the Board at a succession of meetings. The sentiment of the Board was unmistakably opposed to any such project. It saw no reason why the silver certificates should not be retired and the silver behind them released. There was advantage in this because of the fact that never before had it been possible to get back the value of the silver at the rate at which it had originally been bought. It was opposed to the plan whereby the Treasury undertook to buy back in the future at a fixed rate of \$1 per ounce, an equal amount of silver from the silver mine owners. It regarded as the worst feature of the measure, however, the plan to issue federal reserve bank notes. Federal reserve notes were already flowing out from the banks in a steady stream and there was no reason whatever why they should not be issued in an amount

amply adequate to supply every possible requirement. The idea of a gap in the circulation was sheer inflationary imagination.

Accordingly the Board never assented to the project, but the Treasury Department after arranging the terms of the agreement with the congressional interests, announced to the legislative leaders in both houses its desire that the measure should be adopted and, like most of the war legislation, the bill was forced through Congress.¹ At the same time and practically as a necessary consequence of this legislation, a provision was enacted whereby the denomination of federal reserve bank notes and of federal reserve notes themselves was allowed to go as low as \$1 and \$2. This in effect made for a form of money rather than bank currency and, of course, meant that in a very high degree their elasticity had been infringed upon or destroyed. Taken all in all, the act although infringing upon the federal reserve system only in a minor way, was one of unsoundest and most dangerous elements of the entire body of war legislation. It was the direct outgrowth of the control of gold and exchange which thus reacted in a dangerous fashion upon the banking and credit structure of the United States. The subsequent repurchase of silver at a fixed price constituted a subsidy to mine owners which was unwarranted but was of course only a drop in the bucket of evil which had been caused by the enactment itself.

Later Foreign Relations

How far the disturbances caused by the effort to control foreign exchange and to regulate the flow of specie would have gone can be only conjecturally estimated. As the year 1918 advanced, the difficulties connected with the system grew greater and greater, and at times the whole plan seemed to be on the verge of breaking down because of the numerous explanations which had to be issued, the fact that the policy relating to it was falling into an inconsistent jumble, and the incon-

¹ See Appendix

venience and dissatisfaction caused in foreign countries by the working of the regulations. The fortunate arrival of the armistice ended all this and led almost immediately to a relaxation of the regulations. On July 1, 1919, the gold embargo was formally terminated and the system of exchange control which had already relaxed was brought to a close. Business tended to assume its normal course. Some considerable exports of gold left the country as a result of the agreements which had been entered into during the war, but it was not very long before they returned either through other channels or sometimes from the very sources to which they had gone in the first place.

The federal reserve system unquestionably felt it an enormous relief to have this abnormal system ended, but unfortunately there was no effort to substitute anything better or to bring about a system of regular banking operations in foreign bills. From 1919 to the present date, save for sporadic negotiations with foreign countries which have been endeavoring to stabilize their currencies, the reserve system has remained entirely aloof from foreign exchange and largely aloof from the financing of foreign trade save in so far as the purchase of bills stated in dollars may have sufficed to aid in financing current business.

APPENDIX TO CHAPTER LIV

House Bill 13391 "to amend the act approved December 23, 1913, known as the Federal Reserve Act by adding a new section to amend certain sections of the act entitled 'Federal Reserve Act' approved December 23rd, 1913," was introduced March 18th, 1916, and referred to the Committee on Banking and Currency. It was reported back with an amendment—accompanied by report No. 447—and referred to the Committee of the Whole House on March 28th, but not considered until May 4th.

A new section—25a—was to be added to the Federal Reserve Act, permitting national banks to unite and thus form a banking corporation to do business in foreign countries and to subscribe 10% of their capital to such domestic or foreign corporations doing a banking busi-

ness exclusively in foreign countries. 'It was found Mr. Glass explained that under the provisions of the Federal Reserve Act only national banks of very large capital could operate effectively so that of the six branch banks established abroad in the South American countries and in Panama and in Cuba four had been established by the National City Bank of New York, and two by a banking association here in Washington' (Record Vol. 53, p. 7122). The Committee had also originally embodied a provision for domestic branch banking, but in view of the fact that there was considerable opposition to this proposition it was thought advisable to eliminate this provision. The bill passed the House as amended.

When the measure came back from the Senate Committee on Banking and Currency it was changed and enlarged. Accompanied by Senate Report No. 481 it was amended so as to strike out all after the enacting clause and insert instead an amendment to sections 13, 16, 24, 25 and 25a of the Act.

Referring to the first amendment to section 13, as to domestic acceptances Mr. Owen explained on July 14th that the amendment provided for the collection of maturing bills, checks and drafts and for a limited use of domestic acceptances where such acceptances were accompanied by documents conveying or securing title. This section of the bill was further to be amended so as to permit Federal Reserve Banks to make advances to member banks on their promissory notes for a period not exceeding 15 days securing such notes by eligible paper. This is intended to provide an easier method of administration, so that these various notes maturing in a short time shall not themselves be necessarily transferred but may be merely held in the portfolios as collateral, thus permitting the banks to put up its own note secured by this collateral, without transferring the individual notes. (Pp. 11001-11002). Another amendment to section 13 was to provide for 'dollar exchange' and in that way to establish direct communication between the South American and other foreign countries and the United States and to make it unnecessary in transmitting credits to transmit them through London in sterling exchange or through other European countries in terms of money of the foreign country through which the exchanges are transmitted. (P. 11002).

The changes in section 16 relating to Federal reserve notes added to the collateral security which may be placed with the Federal Reserve Agent drafts and acceptances and gold or gold certificates. The purpose of the latter provision, it was alleged, was gradually to have gold certificates displaced by Federal Reserve notes and thus to strengthen the gold holdings of the system. Mr. Owen referred for further ex-

planation to a letter written to him by the Federal Reserve Board and which was reprinted in Senate Report No 481. The amendment to section 24 relative to loans on farm lands, was to permit banks which happened to be situated on the borders of Federal Reserve Districts to exercise their function within a radius of 100 miles regardless of district lines. Section 25 embodied substantially the original House bill, authorizing the various banking institutions of the United States to cooperate in establishing or taking stock in banks which should act as a medium for them in dealing with foreign financial affairs. Section 25a, relating to domestic branches, permitted a bank of a million dollars or more capitalization, within a city, to open branches, not to exceed ten in number and permitted country banks to have within the country branches also not to exceed ten in number. "The purpose of this is to put the national banks upon a parity with the State banks in those States which permit limited branch banking" (P 11002)

When Mr Clapp protested against the manner in which the enactment of so important a measure was proposed, Mr Owen replied that the members of the committee had studied this question for three years past, and that these particular amendments had been under consideration on numerous occasions. Furthermore he asserted that these amendments related to points which had been shown during the past two years of operation to call for improving. "They have been carefully considered by the Federal Reserve Board in extended discussion among themselves. Finally the Federal Reserve Board came before the Banking and Currency Committee and discussed the matter at great length, and the Committee itself then discussed it, and finally determined on this report, which represents whatever of capacity the Committee has" (P 11003)

Several amendments were offered and accepted in debate on the 17th of July. National banks in places with population under 5,000 inhabitants were to be allowed to act as agencies for insurance companies. Another amendment explicitly stated that Federal Reserve banks could not only maintain banking accounts in foreign countries but also open and maintain such accounts for their foreign correspondents. An amendment stricken out in subsequent debate concerned that portion of the reserves which until then had been kept in the vaults of the member banks. This was now to be carried in the Federal reserve banks. Other amendments of smaller importance were largely designed to make the language harmonious. Mr Weeks opposed the provision which allowed branch banking establishments up to 25 miles away from the parent bank and his amendment per-

mitting branch banking only within the cities was agreed to. It was however provided that this power should be exercised only in those States where a similar privilege was granted to State banks. The bill as amended passed the Senate on July the 31st.

The House disagreed to the Senate amendments and asked for a conference, Messrs Glass, Stone and Hayes being appointed as conferees. The Senate insisted upon its amendments and appointed Messrs Owen, Hitchcock and Nelson as conferees.

The Conference Report (S. Doc. No. 533) was submitted to the Senate on August 23. An accompanying statement in explanation of the action by the managers on the part of the Senate contained the following explanation:

The amendments of the Senate to the bill have been accepted by the House conferees with some slight verbal modifications, except that the House declined to agree to and the Senate receded from its amendment of section 16 of the Federal Reserve Act which would have explicitly authorized and encouraged Federal reserve banks to issue Federal reserve notes based upon gold or gold certificates.

The House conferees declined to agree to the Senate amendment proposing to permit national banks in cities of more than 100,000 inhabitants and possessing a capital and surplus of \$1,000,000 or more to establish branches, and the Senate conferees have agreed to recommend that the Senate recede from this amendment.

The House conferees insisted upon an amendment to section 11 which was accepted by the Senate conferees permitting the Federal Reserve Board upon an affirmative vote of not less than five, to permit member banks to carry in the Federal reserve banks any portion of their reserves now required to be held in their own vaults. (P. 13071.)

The conference report was agreed to both in the House and in the Senate without much debate, and the bill was signed on the 7th of September, 1916.

CHAPTER LV

REGULATION OF BANKING AND INDUSTRY

Control of Business

The war had not advanced far before it became plain, not only to the Federal Reserve Board but to many others, that the methods which were being adopted for the supply of credit would not be successful if they were left to work themselves out unaided. At the opening of the war it had apparently been supposed that mere exhortation to curtail the use of certain commodities and not to spend largely would be efficacious. How unfounded such a supposition was became apparent within a very few months. An epidemic of extravagant and luxurious outlay set in. The efforts of administrators at Washington to restrain the use of ordinary commodities such as flour, sugar, etc., was partly insincere or inconsistent, as shown by the enormous hoarding which the government itself unnecessarily undertook, and partly ineffectual as shown by the disregard that was paid to it. Some kind of lip service to "conservation" of sugar and of other things was rendered, but it was not long before the conviction widely spread that, should the war continue for a great while, restriction of consumption would be made effective only through restriction of manufacturing. This led to the thought that the restriction of manufacturing could be supplemented and rendered much more efficient by the restriction or limitation of credit use. From this it was not a long step to the view that the restriction in the use of long-term credit which would prevent the sales of bonds, stocks, and the like for the purpose of developing undesirable or unnecessary industries, might be a good thing. Logically speaking, a still further step was taken in the recognition that it might be desirable to exert not merely an inactive

influence, but also one of positive character, by insuring to certain types of industry the capital of which they stood in need, as well as the credit that would help them to continue business successfully.

This chain of reasoning was not worked out in any definite logical way, perhaps, at the outset, but the various links of it were developed as the outcome of experience, shaping itself through the agency of a great many minds. The consequence of it was to develop on the one hand an elaborate system designed for the control and direction of labor, production, and transportation. This was put into effect partly through the War Department and partly through the various boards, commissions, etc., which sprang up like mushrooms in Washington. A good deal of the work thus done was harmful, or of no effect one way or the other. For our purposes, however, it is worth while to note that it was undertaken. On the other hand, the general philosophy of industry and credit which then prevailed gave rise to the development of a positive program of restriction of supply. The effort to restrict or control the unwise use of long-term credit took shape in what was called the Capital Issues Committee, while the effort to supply what was needed in the way of additional long-term assistance took form in the so-called War Finance Corporation.

Relation of War Finance Corporation to Reserve System

It was apparent from the outset that these war undertakings, whether of restriction or of supply, were very closely akin to the work of the Federal Reserve Board. Assuming that the Board was vested with full control over current banking credit, it was fair to ask whether it was not also the proper repository of authority to control or oversee other forms of credit. Yet there was a limit to what men could do, and it was supposed at the time that the Board, with its moderate membership, was already fully occupied with its duties of completing the organization of reserve banks and adapting

itself to war needs and in general promoting the progress of war financing. On the other hand, it was believed undesirable to commit the management of war financing in these important aspects to a body completely dissociated from the federal reserve system. Such a body could not get the effective control, nor could it afford access to the authentic sources of information that were within the reach of the reserve system. There was no time to work out or develop official amenities and relationships, so that eventually it was deemed wise to place the control of new issues of capital securities in the hands of a committee technically of the Reserve Board but really including a number of outsiders, known as the Capital Issues Committee, while it was resolved to create a corporation, already mentioned, known as the War Finance Corporation, on which the Board and the Treasury should be strongly represented, but which should also include some new members or outsiders and should work through local agencies of various kinds in the different parts of the country.

As has been stated, this program did not take form as a unit or in a logical shape at the outset, but was gradually developed and came into effect by degrees. Although it constituted in many ways one of the most interesting phases of the financial experience of the war, and although it was necessarily closely linked with the operations of the reserve system, it is, after all, not a part of the direct story of banking in the United States and can be dealt with only very briefly in this volume. To that extent, however, it must be summarized, and the chief elements of the work done indicated in their bearing upon the growth of banking policy. Attention may, therefore, first be given to the work of the Capital Issues Committee.

Capital Issues Committee

The Capital Issues Committee was at first established in a purely informal way and without legal recognition. On this

basis it continued for some months, pending the time that Congress should legislate in definite form upon the whole matter. Eventually Congress, on the 5th of April 1918, approved the War Finance Corporation enactment in which, besides establishing the War Finance Corporation itself, appropriation was made in "Title 2" for 'a committee to be known as the Capital Issues Committee and to be composed of seven members.

At least three of the members shall be members of the Federal Reserve Board." The Committee was given due authority "to investigate pass upon and determine whether it is compatible with the national interests that there should be sold or offered for sale or for subscription any issue

of securities hereafter issued by any person, firm, corporation or association, the total or aggregate par or face value of which issue, and any other securities issued by the same person, firm, corporation, or association, since the passage of this act is in excess of \$100,000." The act went on to provide that the Committee should have nothing to do with refunding transactions or with issues made by the War Finance Corporation, or with railroad issues under the control of the government while various other exceptions to its power were made. Authority was given to employ assistance and penalties for violations were prescribed.

The Capital Issues Committee as thus created was speedily established by the President, the membership of it including the same members of the Board who had already been functioning in that capacity in an informal way, while new members drawn from outside were now added and given regular appointments confirmed by the Senate. Thereafter stated meetings were held and applications from would-be issuers of securities were received and passed upon, with the result that the Committee shortly obtained a fairly powerful hold upon the general capital situation in the United States. The results of the Committee's work were large even in nominal amount, but were undoubtedly even more considerable when viewed in the light

of what they implied rather than what they actually accomplished

Effect of Committee's Work

From either standpoint, the establishment of the Capital Issues Committee was a step which was of no small significance. Exactly how it affected the securities market would be a subject of utmost interest and of great scope. Into this it is not necessary to go at the present point. The significant and interesting feature of the case is that, through the agency of the Capital Issues Committee and its work, the banking system was undoubtedly in no small measure freed from burdens which would otherwise in the normal course of affairs have been brought to bear upon it through applications for loans designed to assist in floating or carrying new issues of securities. When it is remembered that these new issues often run up in a normal peace year to figures varying from three billion to three and one-half billion dollars (including refunding issues), it is evident that the work of a committee which practically succeeded in cutting off the major part of such new issues, exclusive of refunding, must be to reduce the natural or normal strain upon the banking system in no small degree. Success in thus reducing it of course meant that the funds which would otherwise have gone into loans of that sort were now held in a liquid condition, and if used for the support of government operations, tended to decrease the bad effects of such borrowing in proportion to their own capital amount.

The work of the Capital Issues Committee naturally required a substantial amount of time on the part of several members of the Federal Reserve Board and in ordinary circumstances would possibly have been out of the question for them. As has been seen, however, the duties of the Board itself as the war progressed became reduced to smaller and smaller compass, until it seemed that the Board might become little more than a routine organization. In these circumstances

the war work of members naturally tended to assume a greater importance relative to their regular work as members of the Board than would otherwise have been the case. Just as the reserve banks became direct organs of the Treasury Department whose function it was to grind out credits and sell securities, so the Board through the Capital Issues Committee was then devoting itself to keeping other securities from being issued and was thus clearing the way for the work of the reserve banks.

The War Finance Corporation

The establishment of the War Finance Corporation was at the time probably of no greater significance than the establishment of the Capital Issues Committee and was not so regarded by those who were conversant with it. It was, however, a step which evidently had far greater potentialities for the future, as subsequent events were to demonstrate. As has been seen, the War Finance Corporation and the Capital Issues Committee were in a sense correlative one with the other, the War Finance Corporation aiming to supply positive aid in the support of those enterprises which needed or required credit and could not get it through ordinary channels, just as the Capital Issues Committee sought to restrict the flow of credit to those enterprises which were easily able to get it under the circumstances.

Exactly whose thought it was that originated the War Finance Corporation would be difficult to say, the fact apparently being that it was the joint product of a number of minds in the Treasury Department and was patterned after the corresponding organization established in Germany soon after the opening of the war. Among the members of the Federal Reserve Board, Mr. Paul M. Warburg probably showed the greatest interest and shared most largely in the task of shaping the preliminary plan. Undoubtedly the thought of Mr. Warburg and others who advocated the scheme was that, since in time of war banking standards are largely

thrown to the winds, there is grave danger that under stress of circumstances many kinds of loans which are needed but which ought not to be in banks will be let in, while others which would be taken care of in ordinary circumstances cannot get attention, and that, therefore, it is desirable in such circumstances to have a special corporation whose function it is to take over the business that either endangers the banks or may be neglected by them. From this standpoint the War Finance Corporation, properly viewed, was intended to be, not a means of promoting interests of special enterprises nor a plan for fostering ammunition factories, as some supposed, but was essentially a means of keeping the ordinary banks of the country as "clean" as possible by putting long-term loans into the hands of a special concern not organized on banking lines but getting its funds through government subsidies.

Merits of New Plan

From this point of view the proposal was doubtless of some merit, although the question may be properly asked whether if such advances were to be made the difference between carrying them in a concern capitalized by the government which borrowed the money from the banks and carrying them directly in the banks, was a very great one. There was, at all events, very large difference between this kind of provision for long-term loans and the proposal which some had made to modify the Federal Reserve Act in a way that would allow these loans to be discounted there. Indeed, the greatest evil of the War Finance Corporation was found in the fact that its framers, in their anxiety to make sure that the concern had plenty of funds, made its paper rediscountable with federal reserve banks, providing that such banks should be authorized "to discount the direct obligations of member banks secured by bonds of the corporation and to rediscount eligible paper secured by such bonds and endorsed by member banks."

Secretary McAdoo, before attempting to put the measure

through Congress, thought it wise to consult Chairman Glass of the Banking and Currency Committee, since obviously the measure would be referred to the Committee and Mr. Glass's assent would be essential. When the measure was brought before Mr. Glass he took it carefully under advisement and reached the conclusion that, hazardous as the scheme was, its hazards should be limited as much as possible. He therefore demanded and secured the introduction into the rediscount paragraphs of a clause providing that "no discount or rediscount under this section shall be granted at a less interest charge than 1 per centum per annum above the prevailing rates for eligible commercial paper of corresponding maturity." Thus, at least, with some other modifications and minor safeguards introduced into the act here and there tended to prevent the "dumping" upon reserve banks of the notes of the corporation or the notes of member banks secured by its bonds—a policy which would have undoubtedly neutralized such good as there was in the original proposal.

Working of System

Although Secretary McAdoo was not very favorable to these changes, it was apparently necessary to accept them, and with but little debate the measure was adopted and the corporation installed in the Treasury Department. Governor Harding was made head and a director of the Corporation, and to it he necessarily devoted during the organization period a considerable amount of his time. The duties of the enterprise being positive, as against the inactive functions of the Capital Issues Committee, considerably more organization and detailed administration was essential. At the outset it was planned to develop a very inclusive type of organization, with offices all over the country. This project, however, was held in abeyance, and within about seven months from the inauguration of the concern the closing of the war happily put an end to any such prospects. So new was the War Finance Cor-

poration and so brief was the period within which it actively functioned, that it may well be doubted whether its effect upon war financing was more than merely nominal. At the close of the year 1918 it held a total of loans amounting to \$38,000,000, a sum which, of course, was insignificant as compared either with the operation of the banks or of the reserve banks, or of the transactions controlled by the Capital Issues Committee.

In forming a judgment of the War Finance Corporation, therefore, one must come to the conclusion that while it might have been an engine of great power and influence in war financing, the late date at which it started, the comparatively early ending of the war, and above all, the fact that the most intense financial pressure of the war did not make itself felt until toward the middle of 1918, all combined to prevent the enterprise from having the influence that it might have had, or indeed from changing the current of events particularly, whether in one direction or the other. Had the war continued a long time it might conceivably have been of beneficial influence, or on the other hand, it might have aggravated the evils of war financing, depending on how it was managed.

Some Results of the Plan

The corporation itself was destined to exert an unhappy influence upon subsequent events in the United States during post-war discussion of banking and credit, but this was a later factor to which no more than a reference need be made at the present moment. The effect of the War Finance Corporation upon the administrative side of the Federal Reserve Board's work was of more importance. It probably tended to sustain the Board in the feeling that it need not relax banking standards any more than circumstances absolutely compelled, since doubtful cases might be referred to the War Finance Corporation. In this way moral support was probably obtained both by the Board and by the reserve banks from the existence of the concern, particularly as the Governor of the

Board had himself a strong voice in the management of the enterprise. Administratively, since it was true that the Board itself was already largely out of commission so far as constructive policies were concerned, the attention required by the War Finance Corporation from Governor Harding and from others did not materially affect the working of the Federal Reserve Board's own machinery in one way or the other. Both in the case of the War Finance Corporation and of the Capital Issues Committee, the unfortunate phase of the whole policy was seen in the effect produced by these undertakings upon the public mind. They tended more and more, to centralize authority in Washington and to make the public look more and more, both for positive action and for positive prohibition, to public officials. They thus tended to stimulate the drift toward a highly centralized organization of industry and to confirm the opinion that whatever was approved at Washington was right.

Industrial Control

Neither the Capital Issues Committee nor the War Finance Corporation probably would have had even the success it attained, had it not been for the application of a vigorous type of industrial control, to which reference has already been made at an earlier point. If, for example, an individual who got credit no matter from what source—whether from his bank or by the license of the Capital Issues Committee from the market, or through the aid of the War Finance Corporation, or in any other way—could use that credit in the manufacture of articles which were not necessary in the management of the war, it might well be doubted whether all of the control thus produced was of any use. Logic, therefore, as already seen, dictated that the government should take the last step in its financial and industrial oversight by undertaking to dictate what concerns should exist and what they should manufacture.

It has already been noted that various tentative measures looking in this direction had been set on foot, and that appeals to patriotism had been made during the early part of the war. These, however, had been found strikingly ineffective for the reasons already given. As the war progressed, it was better and better recognized that the only successful policy would be that of absolutely prohibiting business of certain kinds, while licensing other business. To this was added, on the part of the government, the policy of actually taking over or becoming a partner in certain special kinds of business where large additions to plant were needed or where there was doubt whether the new plant facilities would be able to maintain themselves after the war was over. The government, however, did not have the courage to embark on this extensive program until the late summer of 1918, when it was put into effect through orders definitely issued by the War Department. These orders, however, were necessarily somewhat slow in becoming operative, and it would be quite unfair to form a conclusion regarding the effect produced by them were we to base our conclusions only upon the happenings of the few months which intervened before the armistice. What can be said with certainty is that shortly before the agreement to the armistice had been arrived at, the war financing system of the government was complete, and that had the war continued we should have shifted over to a basis of public manufacture, control, distribution, and banking. How matters would have gone in such circumstances and what would have been the influence thereby exerted upon the credit mechanism, can be judged only by analogy. At all events, these influences were exerted only in a partial and incomplete way during the relatively short time prior to the arrival of peace.

CHAPTER LVI

SOME LESSONS OF WAR FINANCING

Continued War Strains

With the declaration of the armistice, the third period of the federal reserve system's history came, in a certain sense, to an end. It was true, of course, that government financing continued in every real sense to remain subject to war influences for a good while longer. More than two and one-half billion dollars of advances to the Allies were made by the Treasury after the armistice, and enormous quantities of war material continued to be manufactured and delivered. It was necessarily, moreover, a good while before the troops could be returned to the United States. All this meant continuously heavy spending, so that government outlay did not reach its peak until some time after the armistice. The Fifth, or Victory Loan, floated after the armistice, was as great a financial undertaking as any of its predecessors. In a very real sense, therefore, the federal reserve system continued subject to the same kind of strain after the armistice that it had suffered before that date. But in another sense the system entered upon a distinctly new era from the time that peace was positively announced.

As has been made plain in previous chapters, it had long been true that the federal reserve system was obliged to submit to many policies with which it had no sympathy and which it accepted simply because of the existence of war, and the belief that any opposition or resistance would be not only futile but to the rank and file of citizens would seem unpatriotic. The opening of the fourth period of federal reserve history was fundamentally marked by the fact that there was

a psychological change of position throughout the country and even throughout the Administration. The tight grip which had been maintained upon all organs of opinion was necessarily weakened. The autocratic power of the White House began to shrink. The numerous business men and officers who had congregated in Washington for the purpose of price-fixing or of controlling exports, or of otherwise directing the trend of business, imagined in some cases that their work would be continued for a good while, but it did not take more than a few weeks to convince them to the contrary. The public was restive and uneasy, doubtful of the industrial and credit measures that had been pursued during the war, seriously uncertain regarding political methods and policies, and bent at the earliest opportunity upon shaking off the extreme centralization which had fastened itself on the body politic. All this meant that the federal reserve system might now, with proper leadership, assume some measure of independence and might begin the task of developing policies which conceivably would lead to a restoration of normality and soundness in business and banking throughout the country.

Change in Treasury Headship

These matters were not of a nature that could be taken in hand instantly, nor was it certain for some time either what the results of the armistice negotiations would be, or how soon the return to normal conditions could be begun. Just as the members of the Federal Reserve Board and of the system at large had begun to think of the problems presented to them from the peace point of view, it was announced that the Secretary of the Treasury, who of course was also Chairman of the Board, had determined to retire and that his place would be taken by Chairman Carter Glass of the House Banking and Currency Committee. Mr. Glass succeeded Secretary McAdoo practically at the close of the year 1918. The change was undoubtedly regarded with satisfaction throughout the federal

reserve system, largely because of the belief that Mr. Glass would be more sympathetic with the ideas, purposes, and objects of the system than his predecessor had been.

Unquestionably many officers of the federal reserve system, whether justly or unjustly, had come to believe that the policies of Secretary McAdoo constituted a serious danger to the safety and sound development of the federal reserve banks. This may have been, and doubtless was, due to the fact that the policies of the Treasury unquestionably were the more or less inevitable outgrowth of the war. Be that as it may, there was of course some tendency to associate the personality of the Secretary of the Treasury and Chairman of the Board with the policies he pursued. Not a few failed to discriminate between what was necessary or unavoidable and what was voluntary. In the case of Secretary Glass, it was believed that he would be disposed to give the system the scope and latitude which it needed for development, and that he would reverse a good many of the McAdoo policies which were open to condemnation from a banking standpoint. That Mr. Glass would seek the steady evolution of the system and that he would refrain from attempting to dictate or control its essential policies, was widely believed and the change of administration of the Treasury was, therefore, unquestionably received with general approval.

Problems of Secretary Glass

Mr. Glass, however, was controlled by conditions whose force the rank and file of the public could not understand. First of all, he came into the Treasury at a moment when the arrangements for the Fifth, or Victory Loan had been very nearly consummated. Without fixing the exact date for the loan, the Treasury administrators had necessarily, immediately after the conclusion of the fourth issue, begun the plans for placing a fifth. They were determined to continue the old "borrow-and-buy" policy with, if necessary, lower

discount rates at reserve banks, and everything had been shaped with that end in view. The personnel of the great war organization, both of the Treasury and of the reserve banks, was functioning along certain distinct lines, the banking mechanism of the country had developed itself for carrying out a certain kind of policy. To check these plans in mid-career and to introduce a completely new system of public financing would have been not only possible but imperative, had it seemed that further Victory loans would have been required so that the Treasury would find itself obliged to go on financing a costly war for an indefinite period. The situation was rather different when it was realized that the Fifth, or Victory Loan would undoubtedly be the last of the series and that what was proposed in connection with it was merely to finish the McAdoo policies and bring them to a definite turning point. A change to a different policy might have caused serious friction if not collapse of plans that had been worked out in practice.

These questions were given careful consideration by Mr. Glass at the outset of his new official career. He reached the conclusion that it would be best, on the whole, to maintain the McAdoo policy throughout the Fifth Loan and, as a concomitant of it, to keep in effect more or less the same system of borrowing at banks which had been set on foot during the McAdoo régime, introducing only such changes as might be absolutely requisite. Mr. Glass, moreover, was of the opinion that the federal reserve system had come through the war in tolerably good condition, and that inasmuch as private absorption of securities might now be expected to proceed at a much more rapid rate, the conditions created by the Fifth Loan would not enlarge the burden which the banks were carrying and would probably not produce any very serious retardation of progress toward sound condition. Undoubtedly also, there was present in Mr. Glass's mind the more general consideration of party welfare and allegiance. He was essentially a

sound and loyal party man, eminently faithful to the Wilson régime, and a great personal admirer of the President himself. His relationship with Secretary McAdoo had been close, and he would have been the last to adopt any policy that might be regarded as being in any way a reflection or criticism upon that of his predecessor unless there was some very cogent reason for so doing.

All of this was of course appreciated by members of the McAdoo group in the administration, who promptly gave out to the newspapers statements to the effect that the function of Mr. Glass would merely be that of "clearing the desk" left by Secretary McAdoo, or, in other words, to finish certain phases of work which Mr. McAdoo had been unable to bring to a conclusion on account of his hasty departure from the Treasury. Mr. Glass announced that he intended to retain the entire personnel of the McAdoo administration practically unchanged and in so doing he practically bound himself to follow the lines of his predecessor even in more detail than he perhaps realized in his own mind. These conditions placed a rather new face upon the administration of Secretary Glass and made it clear to discriminating officers of the federal reserve system that there was no ground for expecting any sudden reversal of policy, but that, on the contrary, they must prepare themselves to deal with problems of the same general sort that they had been obliged to meet during the war.

Condition of System at Close of War

Nevertheless, it was a fact, as Secretary Glass and others believed, that the position of the federal reserve system even at the close of the war was strong. In far less degree than any other banking system in the world had it suffered from the terrible results of war financing. The immense underlying strength of the country had preserved it, the member banks taking up the great bulk of the loans that were offered, while

the federal reserve system, even after the close of the war, had a ratio of cash reserve amounting to more than 50 per cent. This situation can be clearly perceived by considering the following condensed statement of condition as it appeared at the close of the war, about two weeks prior to the technical declaration of the armistice. The period is selected as affording a fair showing of the war financing factors which had already taken effect prior to the armistice and were making themselves felt.

RESOURCES AND LIABILITIES OF THE FEDERAL RESERVE SYSTEM AT
THE CLOSE OF BUSINESS, OCTOBER 25, 1918

RESOURCES

Gold in vault and in transit	\$ 376,679,000
Gold settlement fund, Federal Reserve Board	415,676,000
Gold with foreign agencies	5,829,000
Gold with federal reserve agents	1,184,998,000
Gold redemption fund	61,950,000
Total gold reserves	2,045,132,000
Legal-tender notes, silver, etc	53,037,000
Total cash reserves	2,098,169,000
Bills discounted	
Secured by government war obligations	1,092,417,000
All other	453,747,000
Bills bought in open market	398,623,000
United States government long-term securities	28,251,000
United States government short-term securities	322,060,000
All other earning assets	24,000
Total earned assets	2,295,122,000
Uncollected items (deduct from gross deposits)	856,923,000
Five per cent redemption fund against federal reserve bank notes	3,692,000
All other resources	16,879,000
Total resources	5,270,785,000

LIABILITIES

Capital paid in	\$ 79,190,000
Surplus	1,134,000
Government deposits	78,218,000
Due to members—reserve account	1,683,499,000
Collection items	702,107,000
Other deposits, including foreign government credits	117,001,000
Total gross deposits	2,580,825,000
Federal reserve notes in actual circulation	2,507,912,000
Federal reserve bank notes in circulation—net liability	58,859,000
All other liabilities	42,865,000
Total liabilities	5,270,785,000

The system was evidently amply able to take care of itself. It still had abundant vigor and vitality and, had it been left to itself, might have corrected the conditions which had resulted from the war finance policy. The effect of the war had been most injurious in many ways. It had not only produced the effects which were superficially apparent in inflated currency, enormous holdings of government obligations, and extension of what were practically long-term renewal loans in favor of banks which discounted the customers' collateralized notes, but it had slipped far away from the earlier traditions that had been developed even during its short life prior to the war. There was a very serious problem to be met at the time, but it was rather different from the problem ordinarily conceived of. It was rather the problem of overcoming bad traditions, practices, and habits in banking and of adopting sounder methods than it was that of repairing that of a broken or disorganized credit structure.

Condition of Credit

The condition of credit at the close of the war was, after all, not disastrous. The banking system might very properly have been regarded as on the brink of disaster but, as subsequent events showed, it had certainly not been pushed over the brink. Even with the post-war inflation which had been allowed to develop, the finances of the country continued upon a workable basis. Had measures of contraction been vigorously applied just at or subsequent to the close of the war, the inflation which followed might have been checked or overcome. Certainly the credit situation was emphatically within the power of the system to control. The problem was that of obtaining the consent of the system itself and the collaboration of the Treasury Department in bringing about the restoration of sounder and better things. Unfortunately, the temper of the community was adverse to any such program. The enormous war profits which had been gained by manufacturers and

dealers had made a large section of the community eager to press forward along inflationary lines, and what would have been their attitude toward a genuine effort to restrict inflation may properly be questioned. Nevertheless, as already observed, the credit condition was still within control and it was entirely possible to obtain a revision of the banking portfolios of the country with a view to greater soundness and the gradual exclusion of war paper.

Service of the Reserve System

The service of the reserve system during the war period had undoubtedly been of inestimable value to the community. It would indeed be difficult to compute it too highly. This service was the more important in that it had been unexpected. No one had looked forward to any such use of the reserve banks. All had regarded them as a peacetime measure and yet they had functioned splendidly in a time of unusual and even unprecedented pressure. This service on the part of the system was, however, of a wholly anomalous type. It could not be expected to continue indefinitely, nor could the reserve banks in any conception of their duties be regarded as in any way likely to maintain themselves on the basis which they occupied at the close of the war. This can be readily appreciated when we remember that the earnings they had made prior to the war were normal, while during the war they immensely increased. Of this situation the Board said ¹

The total earnings of the Federal Reserve Banks for the calendar year 1919 were \$102,380,583, compared with \$67,584,417 for the calendar year 1918, while total current expenses were \$20,341,798, compared with \$12,137,438 for the earlier year.

As a result of increased borrowings by member banks and the higher discount rates adopted, the earnings of all the Federal Reserve Banks show considerably higher totals for the last three months than for the earlier months of the year.

Current net earnings of the banks—i e, the excess of earnings over

¹Report, 1919, p. 229

current expenses—totalled \$82,038,785, compared with \$55,446,979 for 1918. Calculated on an average aggregate paid-in capital for the year of \$83,513,000 the net earnings for 1919 constitute 98.2 per cent as compared with 72.6 per cent on the average paid-in capital in 1918.

Under section 7 of the original act the bank had to carry to surplus one-half of their net earnings up to 40 per cent of their paid-in capital and had to pay the other half to the Government as a franchise tax. In accordance with this provision, the banks, at the close of 1918 carried to surplus \$21,605,901, and under instructions from the Reserve Board concurred in by the Treasury set aside the balance of their net earnings \$26,728,440 as a special reserve for payment of the franchise tax. On March 3, 1919, an amendment to section 7 was enacted whereby all net earnings, after deduction of 6 per cent dividends, were to be paid into a surplus fund until this fund should have reached 100 per cent of the total subscribed capital and that thereafter 10 per cent of such net earnings were to be carried to surplus, while the remainder was to be paid as a franchise tax to the Government. This amendment was made applicable to the net earnings for the calendar year 1918, and accordingly the Federal Reserve Banks transferred to surplus account the amount of \$26,728,440 reserved at the close of the year for franchise tax.

At the end of 1919 net earnings, after payment of dividends, amounted to \$73,355,672 and of this amount \$70,651,778 was carried to surplus, while the balance was paid to the Government as franchise tax by the New York bank, whose surplus is in excess of 100 per cent of its subscribed capital. For the other banks the ratios of surplus to subscribed capital stand as follows:

	Per cent		Per cent
Boston	58.8	St. Louis	45.8
New York	100.7	Minneapolis	58.0
Philadelphia	55.8	Kansas City	76.1
Cleveland	47.7	Dallas	41.5
Richmond	66.3	San Francisco	65.3
Atlanta	68.5		
Chicago	57.9	System	68.7

Of the total earnings of the banks about 78.9 per cent as against 71.5 per cent in 1918, came from discounts, largely war paper, bills purchased in open market contributed about 13.7 per cent of the total earnings, as against 17.7 per cent in 1918. United States securities, chiefly Treasury certificates, 5.6 per cent, as against 5.7 per cent the year before, transfer operations yielded about 0.8 per cent of the

annual earnings, compared with 15 per cent in 1918, while the balance of the earnings represent penalties including interest on deficient reserves, collection charges, profits on sales of foreign coin, and sundry smaller profits

Of the total expenses of operation of the banks proper, exclusive of their fiscal agency departments, \$7,103,547, or about 46 per cent, as against 42 per cent the year before, went as compensation to the clerical staff, and \$1,418,144, or about 9 per cent, as against 115 per cent in 1918, as salaries to bank officers

The earnings gathered in during the years 1918 and 1919 represented the war increase in the activity of reserve institutions, just as the growth of their staff in another way afforded a basis of comparison with former years. They had assumed an undeniably inflated status both in their portfolios, in their earnings, in their personnel, as well as in their relation to the community. The question was how best and most wisely to break away from that status and to restore the older and more normal conditions which might properly be expected to prevail over a period of years

Erroneous View of Credit

The public, however, had received a very bad kind of education. Inflation had not gone far enough to show to their eye the really disastrous effects of the process of overexpansion. It had intoxicated the country, but the intoxication had not gone to the stage of absolute debauchery. The average man apparently regarded credit as a never-failing stream whose flow could be relied upon to fertilize even the most barren areas of commerce. The banks, too, had largely lost their sense of proportion, as appeared soon after the war, when an era of dangerous and unwise financing set in. They were of the opinion that, with rising prices, almost any kind of business could be conducted successfully and they had in many cases lost their horror of government intervention. With the government in the market as the greatest buyer of goods, and with government certificates of indebtedness as the funda-

mental commercial paper, the banking business was comparatively easy, and loss was hardly to be feared even in the exchange field where the "pegging" of rates had prevented the slightest hazard from making itself felt in the principal exchanges. Even in reserve banks it was a notable fact that some of them, in reporting on the operations of the year 1918 remarked with pleasure the action of member banks in holding a large quantity of certificates of indebtedness and expressed the opinion that, if this practice could only be continued, the banks being thereby helped to keep their resources partly in "liquid" form, a great stride forward would be taken in assuring a sound condition of the banking mechanism. It needed only a statement of this sort to show how deeply the poison of war financing had corrupted the standards of banking and financial practice the country over. This may in some measure be regarded as a fault on the part of the federal reserve system in not having set its face firmly against inflation. The answer is the one already given— that the system was neither strong enough nor independent enough of government authority at the opening of the war to adopt any such course of resistance to the public powers even had the members of the system been inclined to pursue it, while it may be added that there is still, even among well-informed men, a difference of opinion as to whether the war could have been financed without some form of inflation as an incident.

Be this as it may, and be the responsibility for conditions that of the government or of the federal reserve system, the fact is that the greatest harm of the war financing period had not been seen, namely, that the banking system was so seriously "water logged" with government obligations. It was the fact that many bankers and financiers had lost their fear of the methods that were being pursued, and were inclined to favor their continuance. All this created a psychological situation which should be borne in mind by those who wish to form a fair conception of the service rendered by the federal

reserve system during the war, and who wish to be reasonably fair in their judgment of the post-war policies, or who wish to be certain in their own minds of the true nature of the obstacles which the reserve system encountered in its struggle against inflation during the years 1919-1920. A definite condition had been developed in the public mind and had to be reckoned with as a factor of the first importance, in other words, the reserve system found itself obliged to take account of the temper of the public, just as it had constantly been obliged to take account of the temper of the Treasury Department and of the politicians generally as a conditioning or limiting factor in all of its operations.

Subordinate Position of the Federal Reserve Board

The difficulty in the situation from the standpoint of the Federal Reserve Board, undoubtedly lay more largely in this psychological situation than it did in any of the technical aspects of banking or financial conditions. Could the Board regain the leadership which it had been intended to exercise or not? Could it recover the ground which had been lost by reason of the controlling position which the Treasury Department had assumed? Could the Board expect to re-establish its independence and that of the system, or must it look forward to a permanent dependence upon the Treasury? In dealing with this problem it was greatly handicapped by the fact that the reserve system itself had gradually come to hold the Board in a lower regard.

The question of re-establishing the prestige of the controlling agency in the system was thus both a pressing problem from the public standpoint and a matter of no little difficulty from the internal standpoint of the system itself and of the government in general. Moreover, it was necessary that the Board should now address itself very directly to the conservation of credit. This was a matter to which more and more attention had been given during the latter part of the war, but

with less and less hope of applying the principles laid down. How far would it be possible after the close of the war to obtain adherence to a policy of supervision or control in business and in speculation? This question was now to be disposed of. The situation (as it existed just shortly before the armistice and as reviewed by a member of the Board in a memorandum² generally distributed at that time) called for careful survey of the rate problem. The memorandum was given study by the Board, and undoubtedly represented a feeling which had become nearly universal among its membership. The declaration of the armistice did not change the situation presented to the system, for the war financing still continued for a good while after it, or, to put the matter in another way, the war was not over in the financial sense for much more than a year subsequent to the armistice. The lessons of war financing learned during the first year of the struggle were thus appropriate and fresh for application at the close of 1918.

APPENDIX TO CHAPTER LVI

MEMORANDUM ON DISCOUNT RATES SUBMITTED TO FEDERAL RESERVE BOARD BY A MEMBER JUN 27, 1918

With the approach of a new fiscal year and the offering of the first of a new series of Certificates of Indebtedness to be issued fortnightly to the amount of seven hundred and fifty millions of dollars until the first of October, the financing of the war enters upon a second and more serious phase. Careful reckoning should, therefore, be taken in order that the results may be satisfactory. We should be careful not to draw too optimistic conclusions from the results and experiences of the first year of our war financing.

During the past fiscal year, the expenditures of the Government amounted to over twelve and a half billions of dollars, which is almost six billions less than the expenditures that were estimated for the year—the difference being accounted for largely by inability of the Government to expend all the money that had been appropriated for the goods and services which were needed for the conduct of the war. It has

² See appendix, below

placed three loans, to the amount of almost ten billions, and each of the loans was preceded by an offering of Certificates of Indebtedness

The extent to which the loans issued by the Government have been actually and definitely absorbed can not be stated with finality. The increased totals for banking operations, both for Federal Reserve banks and the ordinary banks of the country, would seem to indicate that in one way or another the borrowings of the Government were in part responsible for the banking expansion. Deposits increased over thirteen hundred millions between May 1, 1917, and May 10, 1918, loans and discounts increased between the two dates five hundred and eight millions of dollars and investments in United States bonds and certificates of indebtedness (largely certificates of indebtedness) increased between the two dates, one billion eight hundred and eighty-nine million dollars, as set forth in the abstract of the Comptroller of the Currency under date of June 20, 1918.

To get a fair basis for estimating movements in leading items of the Reserve Banks, a date subsequent to the important amendments of June 21, 1917, must be chosen. Between the dates of June 22, 1917, and June 21, 1918, the gold and cash holdings of the Reserve Banks have grown from \$1,247,698,000 to \$1,981,111,000, loans and investments from \$552,790,000 to \$1,240,602,000, and reserve deposits from \$1,440,597,000 to \$2,029,557,000. The reserve percentage has moved between the two dates from 71.6 to 63.4 per cent. There has thus been a noteworthy decline in the reserve strength of the Reserve Banks, notwithstanding the fact that the gold and cash holdings have been increased by \$733,413,000 through State bank membership and through gold voluntarily turned into Reserve Banks in exchange for Federal Reserve notes and otherwise, and notwithstanding the fact that the first phase of the war financing passed off with considerably greater smoothness and ease than anyone dared anticipate when the first Liberty Loan was offered. The situation is calculated to awaken very serious reflections as to the consequences that may not improbably be expected to follow the vastly increased financial requirements for the fiscal year 1919, if excessive reliance is placed on banking credit to meet the requirements.

II

The estimated expenditures of the Government for the next fiscal year are expected, according to statements of the Secretary of the Treasury, to reach an aggregate of twenty-four billions of dollars.

To meet them, it is proposed to levy new taxes, chiefly on war profits, incomes and luxuries, which are expected to yield, with existing taxes, an aggregate revenue of some eight billions of dollars. Supposing that Congress authorizes as high an additional tax levy as that recommended by the Secretary of the Treasury, it is clear that the contemplated outlays of the Government will require the placing of loans to an aggregate of not less than sixteen billions of dollars.

This is the most stupendous program that has ever been proposed by any government. The contemplated outlay for the single year amounts to more than two-thirds of the outlays of England since the beginning of the war. How is the country to take care of the vast outlay contemplated?

We have no accurate means of knowing what the total money income of the people of the United States is at the present time. If it be assumed that it may amount to as much as fifty billions at the present time, it would appear that the contemplated financial program of the Government for the fiscal year 1919 will absorb about one-half of the total money income of the country for the use of the Government. Stating the problem in its economic dimensions, it means that roughly one-half of the current product of the industry of the country—that is, one-half of the goods and services produced or putting the same thing in more fundamental terms, one-half of the productive capacity of the country—must be withdrawn from producing for private consumption and be put at the disposal of the Government for the fiscal year 1919 producing such things as the Government requires for the equipment, supply and use of its armed forces and those of the governments associated with it, and, in addition, considerable quantities of provisions for the use of the civilian populations of the allied countries.

The economic problem with which we are confronted, therefore, is that of cutting down the consumption of the stay-at-home civilian population in our own country to about 50 per cent or one-half, of the product of our current industry. It seems clear without argument, that this can be accomplished only by drastic revisions of customary habits and modes of living for all classes of our population—in other words, by the practice of thrift and saving on a scale of the greatest intensity. Goods of every description must be saved or altogether dispensed with, services must be saved, and, as a powerful auxiliary factor in the process, credit must be saved.

Thoughtful men everywhere in the country see that living and busi-

ness can not be "as usual" if the war is to be expeditiously and effectually financed. It follows that, if business can not be allowed to be "as usual," neither can credit. It is an especial responsibility of the Federal Reserve System to emphasize this fundamental truth, because it now looks as though business will go on being much "as usual" as long as credit is "as usual." There is, therefore, no more important problem confronting the Federal Reserve System than that of devising ways and means of exercising such control or influence over commercial credit, as will restrict its being used for dispensable and less-essential purposes and keep the way open for Government financing and other essential purposes. The President, in his proclamation of May 29, 1918, called attention to the fact that "all of our one hundred million people must be economically and industrially adjusted to war conditions if this nation is to play its full part." Industry and living, however, can not be trusted to automatically adjust themselves to war conditions, however clear the need may be. The initiative must be taken by some authoritative agency, and that means by the Government. The problem is too big to be handled by unofficial agencies, however willing they may be to co-operate with the Government. That is why the war has given rise to a whole series of new governmental establishments to handle the difficult commercial, industrial and financial conditions produced by the war. The adjustment of the industrial and economic life of the nation to war conditions is their peculiar responsibility and a leading objective to the policies of such bodies as the War Trade Board, War Industries Board, the Railway, Food, and Fuel Administrations, War Finance Corporation and Capital Issues Committee, is to exercise such a control and direction over trade and industry as will divert our national energies from non-essential and less-essential activities to those which are vital in hastening the supply of the Government with needed goods and services.

While the Federal Reserve Board is not one of these new agencies called out by war conditions, it, nevertheless, has a very important work to perform in helping forward the necessary readjustments of business and industry to war conditions. The Federal Reserve System—that is, the Federal Reserve Board and the Federal Reserve Banks—must, therefore, have convictions on questions of fundamental policy and must have the courage to advise and act on those convictions, if the system is to be a real factor in helping to shape a national economic and financial policy that will make for strength, stability, endurance and ultimate victory.

III

What then can the Federal Reserve System do to help and hasten the adjustment of business to a war basis? This is a question which should have the constant and most studied attention of all who are concerned in the administration of the system. The field of the Federal Reserve System is not an unrestricted one neither does it alone exercise influence in that field but its field is a broad one and its responsibility great. The War Finance Corporation was set up to help meet the capital requirements of essential industry and the Capital Issues Committee was established to exercise a kind of censorship over the issue of new securities. The field of the Federal Reserve System is commercial credit and our instrument of operation is the discount rate. This can not be too strongly or insistently emphasized. When the Federal Reserve Board speaks authoritatively and effectively it speaks through discount rates. All else is incidental. The law has laid down the broad principle for the guidance of the banks and the Board in the fixing of rates when it declares that rates "shall be fixed with a view of accommodating commerce and business leaving it to the discretion of the banks and the Board to determine what measure and kind of accommodation should be extended to different kinds of commerce and business in given conditions. Doubtless in all ordinary circumstances, the banks and the Board, in the exercise of their discretion, might safely proceed on the assumption that all kinds of legitimate commerce and business, in the absence of special need, are entitled to equal consideration. But the present are highly unusual times and call, therefore, for the exercise of a wisely informed discretion on the part of those who control the discount policy of the country.

The question for us to consider, therefore is what does the accommodation of commerce and business suggest at this time as an appropriate discount policy. To ask the question is almost to answer it so obvious are the requirements of a good, national economic policy at this time. *The business of the nation now is war*, and whatever private business obstructs the nation's business should be entitled only to that minimum or accommodation which is absolutely necessary. This means specifically at this time, as one most important step in the development of a proper national discount policy, that rates should be so fixed as to offer no encouragement to non-essential and less-essential business. The Reserve Banks have at last attained a position where the rates established by them exercise a controlling influence in the market, and we can not escape the responsibility of deciding how we

are going to use that influence whether to maintain rates at an artificially low and easy level, with all that such low rates will imply in stimulating or maintaining ordinary business at its usual pace, or whether to adjust our rates to changing financial and economic conditions, in order to bring about curtailment in the use of commercial credit and thus to help bring about the adjustment of industry and living to war conditions, to which the President has called attention. The adoption of this latter policy suggests that rates should pretty generally be increased at all Reserve Banks at once or in the very near future, and no exception, in my opinion, it may be added, should be made of the rate on the 15-day notes of member banks secured by Certificates of Indebtedness.

IV

The fact that the Treasury has started with its program of bringing out fortnightly issues of Certificates of Indebtedness in amounts of \$750,000,000 up to October 1st, compels us to give immediate attention to any change which may be necessary in the rate on paper secured by such Certificates. The present rate at all Reserve Banks, except Kansas City and Richmond, is 4 per cent, with no announced restriction on renewals. At Richmond and Kansas City, the rate was recently advanced to $4\frac{1}{4}$ per cent on recommendation of their boards.

It is my opinion that while conditions at Kansas City and Richmond are at the moment somewhat peculiar, they are not so different from conditions which other districts will soon have to face, as the borrowing program of the Government develops pressure on the banks which are expected to subscribe an amount equal to 20 per cent of their resources to Certificates of Indebtedness. If the banks undertake to carry their quotas of Certificates as an extra load without making room for them by contracting commercial loans wherever that can safely be done without jeopardizing essential industry, the burden will come in undue amount onto the Reserve Banks and show its effect in a weakened reserve position. If, on the other hand, rates on 15-day Certificate-secured paper be raised, it will at least indicate the desire and expectation of the Federal Reserve System that it is not to be made so easy for member banks to carry the Certificates as an extra that they need do nothing to curtail. In other words, to put the matter bluntly, the Federal Reserve Board having preached the absolute necessity of saving and curtailment, ought to show that it has the courage of its convictions by adopting a discount policy which is somewhat

more in accordance with its announced views than the maintenance of a 4 per cent rate would imply

As a matter of principle, it would appear that the rate which the Treasury has to pay on its short-term paper is the best indication and measure of the state of the money market and should, therefore, determine the rate established by Reserve Banks on Certificate-secured notes. As a matter of banking expediency, however, we have followed the practice of allowing a differential under the Government rate on such paper, and, it may be admitted, that it would be impracticable at this time, even if regarded desirable on general grounds, to change the practice. The question at the moment is therefore one of diminishing this differential from one-half to one-fourth of 1 per cent by making the rate at which 15-day $4\frac{1}{2}$ per cent Certificate-secured notes of member banks will be taken by Reserve Banks, $4\frac{1}{4}$ per cent instead of 4 per cent as at present.

Are there any objections to be made against such an increase at this time on grounds of expediency which the Banks and Board ought to respect, even if we are agreed that as a matter of general banking policy, the reasons for an advance of Reserve Bank rates are conclusive?

Vague apprehension has been expressed that an advance of the Reserve Bank rate to $4\frac{1}{4}$ per cent might endanger the negotiation of the $4\frac{1}{2}$ per cent Certificates of Indebtedness. It is of course clear that the Certificates will have to be placed with the banks and that their feelings are a factor that may not safely be overlooked. They feel that they ought not to be expected to take liberally of the current offerings of Certificates unless they are assured a comfortable margin below the rate carried by the Certificates, thus enabling them to get accommodation, as they need it at the Federal Reserve banks and at the same time make a certain profit on the transaction. How much concession should be made to this feeling and expectation of the banks? Enough, but not more it seems to me than is necessary to enable the banks to handle the business without loss. One-quarter of 1 per cent will do this and leave a slight profit. To fix a rate for the purpose of enabling them to earn more implies distrust of the disposition of the banks to help the Government unless the transaction is made sufficiently profitable. It raises a doubt as to the patriotism of the banks in wishing to help through the banking end of the Government's gigantic financial program which I believe the vast majority of the banks would be quick to resent and give the lie to. The bankers are going to take the Certificates, not because they want them, but because the Treasury

needs their assistance. The really patriotic banker will not be materially affected by the difference in rate, and the weak banker ought not to be unduly encouraged to rely upon the Reserve Banks in handling his Certificate purchases by a too low rate on rediscount. Nor should he be misled by the maintenance of an unchanged rate of 4 per cent at the Reserve Banks into thinking that the Federal Reserve Board and the Banks are taking an easy and comfortable view of the situation. Such, we know, is not the case. We know that the country is faced with very heavy financial responsibilities, there is no easy way out of them. Resoluteness and courage in facing the facts were never more needed than at the present moment. The country—it is my firm conviction—people of all classes, bankers and business men as well, are ready to do whatever they are told must be done. Are we ready to tell them in the simple, but nevertheless important and significant, manner of the discount rate? We can not escape the question and the responsibility which is ours as managers of the Federal Reserve System.

CHAPTER LVII

POST-ARMISTICE FINANCE

Board and Treasury

The policies of the federal reserve system after the conclusion of the armistice could not be developed without due consideration of the wishes and needs of the Treasury Department. As has been mentioned at the close of the foregoing chapter, the Treasury had by no means seen the close of the war so far as its problems were concerned. It had already advanced to foreign countries something like seven billion dollars, but as matters turned out, further advances of about two and one-half billions were to be granted. The armistice was hardly in effect when Secretary McAdoo announced his intention of retiring from the Treasury Department, and shortly thereafter Chairman Glass of the House Banking and Currency Committee was nominated as his successor by the President.

Mr. Glass was thus faced with the difficulty of taking over a system of war financing which had been extensively developed and which was now in full swing, the problem being whether to continue this system as it stood or to substitute something else. He had of course devoted much attention to the question of war finance in his capacity as head of the House Banking and Currency Committee, yet the responsibility of taking over a great enterprise like the Treasury Department which was already in full operation upon distinctive lines, necessarily meant some change in point of view. To him, therefore, upon assuming the Secretaryship of the Treasury, was presented the question how to complete the enormous pro-

gram of outlay which he found it necessary to provide for and at the same time to eliminate those elements in the plan of finance which did not commend themselves to him

Choosing a Policy

Secretary Glass did not deal with this problem blindly, but at the very beginning of his administration contemplated definitely the question whether he ought to continue the country for some time longer practically upon a war finance basis, or whether he should endeavor to get back as soon as possible to the system of individual control of, and responsibility for, industry. In dealing with this question, many complex factors had to be considered. It had already become plain, even to the less discerning, that war control of business was producing serious difficulties and dangers. The diversion of capital into undesirable channels, the exaggeration of war industries, the artificial condition in the money market, the steady inflation of all kinds everywhere in evidence, were rapidly transforming the business and finance of the country. At the same time, the restrictions which had been thrown about transportation, business, industry, and consumption were proving extraordinarily irksome to the average man. He was dissatisfied with conditions, being appalled by the terrific burden of taxation and frightened by the rising rates of wages and of business costs, as well as by the steady advance of prices. There was a very powerful and respectable school of thought which was of the opinion that war restrictions and war control should continue for some time longer. But the arguments against this point of view were so cogent that the new Secretary of the Treasury early reached a determination to revert to normal conditions as soon as he could.

Abolition of Capital Issues Committee

With this in mind, one of the first steps to be taken was undoubtedly the release of the investors of the country from

the restrictions imposed upon the use of their funds. As has been elsewhere seen, these restrictions had been applied by the Capital Issues Committee, which had continued to get a stronger and stronger hold upon the business of the nation as time had gone by. This limitation of investment had undoubtedly caused considerable hardship, and comparatively early in Mr. Glass's administration the Committee was advised that it might well reduce its activities. The reductions took place and were followed not long after by the abolition of the Committee entirely. The effect of the action naturally was to give renewed freedom to those who desired to restore investment to normal channels, and hence brought about a comparatively early development of new security offerings in the market coupled with applications to banks for additional credit and a general restoration of investment to the lines it had previously followed.

Abolition of Money Pool

Elsewhere it has been recalled how, for the purpose of restricting undue speculation, it had been deemed best to develop a so-called Money Pool Committee in New York, whose purpose it was to enforce reasonable rates and to ensure moderate supplies of money to brokers and others upon condition that such operators would restrict their total borrowings to a specified level. This money pool had, of course, been extremely restrictive in its effect upon speculation and was correspondingly distasteful to trading interests as well as to brokers. That in itself was not particularly an objectionable situation, inasmuch as the restriction of active speculative operations was to be desired until business itself had returned to normal channels; but the work of the Money Pool Committee was inflicting hardship upon some elements in the community and at the same time working in the interests of others, even with the best of efforts to make it equitable in its transactions. The fact that the money pool was being conducted

in a certain sense under government supervision, moreover, appeared to make the Treasury partially responsible for the maintenance of low rates of interest in the call money market and seemed likely to entail a reserve bank policy that might be open to criticism

Mr Glass accordingly determined to eliminate the money pool, or at all events to withdraw from participation in it in so far as the Treasury could be considered to be a participant. This intention on his part was speedily announced and the money pool practically reduced and soon thereafter terminated its operations. The effect of this measure was that of releasing speculation from control and at the same time permitting the rate of interest in the call market to be regulated by ordinary supply and demand. One result of such action undoubtedly was to facilitate the restoration of active speculation, even though it was possibly true that the beneficial result of the policy more than outweighed the inconveniences to be expected from it. Nevertheless it was unquestionable that the dissolution of the money pool brought a larger amount of demand for funds to bear upon the banks and through them upon the reserve banks.

Relaxation of Industrial Control

At the same time that the Treasury Department was thus endeavoring to restore private finance to normal channels, other departments of the government were gradually relaxing their grasp upon business. The War Industries Board, as well as the numerous other administrative organizations which had developed a control of business, practically suspended the most annoying of their regulations within two or three months after the armistice, for those which sought to continue this type of control found themselves so strongly opposed by public opinion that a change of front was almost instantly necessary. Business thus tended to slip back into its accustomed channels, and finding great opportunities still

open to it by reason of the continuance of war finance and war demand in many countries, it immediately began to make heavy demands upon the banking mechanism. These demands naturally implied a tendency to higher rates of interest, larger loans at banks, and, of course, heavier rediscounts.

Continuance of War Finance

All this would have been nothing more than the early restoration of normal conditions, had it been possible to restore public finance at the same time to a normal basis, but Secretary Glass found this to be out of the question. Not only had the plans for the Fifth Liberty Loan been practically matured, but it soon became apparent that foreign countries would be applicants for additional credit for a good while to come. It was, moreover, true that the placing of an enormous loan by popular subscription was evidently likely to be a harder task than before the close of the war, due to the reduction in enthusiasm and interest. So when Mr. Glass was faced with the question of putting the Fifth Liberty Loan upon the market at a rate corresponding to the prevailing market charge for money, the difficulties in the way of such action appeared to be insuperable. They were undoubtedly great, for had he announced that the new issue would be fully subject to taxation and that it would not enjoy special privileges at reserve banks, there might have been very serious difficulty in floating it. Lengthy discussion with the subordinate officers of the Treasury Department led to the decision to divide it into two sections, the one tax free at $3\frac{3}{4}$ per cent, the other subject in large measure to taxation at $4\frac{3}{4}$ per cent, but the use of this divided method of borrowing practically committed the Treasury to a demand for the continued maintenance of very low rates of discount at reserve banks. This meant, in a word, that while the government and the Treasury Department were putting business back into normal channels as fast as they could, they were keeping finance and banking in war chan-

nels for a very much longer period—a condition which may have been unavoidable but whose results were nevertheless bound to make themselves felt for a time

New Type of Speculation

The Federal Reserve Act had originally provided that there should be no eligibility for paper made for a speculative purpose. Only such paper as might be made to finance bona fide commercial, industrial, or agricultural transactions should be admissible to discount. The framers of the act, having no power to foresee or predict the advent of extensive new war finance needs, or to forecast the outbreak of the European struggle at all, could not have made wise restrictive provisions with respect to government credit. They had specified that the bonds and notes of the government should be available for trading at federal reserve banks, but they had not undertaken to limit in any way the activities which reserve banks might see fit to engage in with respect to them. The opening of the war thus found the federal government entirely untrammelled with regard to its dealings with federal reserve banks, and the result was the immense burden of financing which fell upon them. It is quite probable that, had any restrictive provisions existed in the law, they would have been repealed, since the primary purpose both of the government and of the people was, of course, that of insuring a victory after hostilities had been opened. Such a victory, however, had now been gained, and the question how to return to normal financing was uppermost.

Yet in this very emergency the policy adhered to by the Treasury and reserve system was such as to defeat the original purposes of the law itself. As the notes which had been made by customers of banks for the purpose of paying for Victory and Liberty loan subscriptions fell due, such customers gradually paid them off, and it had been expected that the banks themselves would correspondingly reduce the amount of their

borrowings at federal reserve banks This, however, was far from being the outcome, for the reserve banks found during the spring and summer of 1919 that there was no shrinkage in their outstanding claims upon members

Stock Market Loans

Investigation soon showed that the member banks, instead of paying off their loans at reserve banks, were now lending the money in the stock market Others were lending it for purposes of local speculation in their own communities and to some extent probably in land and building operations The reaction which had taken place in credit and in government restrictions upon security issue as well as upon business in general had tended strongly to throw demand back upon the banks, as we have seen, while the upward course of inflation with the higher prices which were being realized made it worth while for business men to borrow heavily in order to buy commodities Stocks released from the restraint of the war years offered an inviting field of speculation Thus the banks not only failed to reduce their commitments with reserve institutions but even tended to increase them, with the result that federal reserve resources, as fast as they were withdrawn from the support of government bonds, were turned to the support of private issues and of private transactions It was a situation directly the reverse of any which had been contemplated in the original Federal Reserve Act and, although it was fully known to the Federal Reserve Board, that body did not see its way clear to any remedial action without the advancing of discount rates, particularly as applied to notes protected by government bonds This was out of the question so long as the Treasury insisted upon the low rates which it deemed essential to a successful management of war finance

Board vs Banks

Reserve banks themselves were hardly in a position to take

any action. They had been directed to discount member bank notes with government obligations as collateral, at a specified rate, and had not been instructed to inquire too narrowly into the purpose for which the funds were being used. They merely continued during the year 1919 the same policies which had been in vogue during the years 1917-1918 and, with some justice, they assumed that the action of the government in releasing the control which had been exerted over the financing of new issues and the development of business amounted to the giving of a license to individual business men to proceed with their operations as best they could. In these circumstances it was undoubtedly a question in the minds of many whether they were called upon to interfere with the development of the speculative mania. Certainly they did not do so until that development was very far advanced, a point being reached at which any control of it could be exerted only with considerable difficulty. Thus as the year drew steadily toward its close, the inflation of prices continued as rapidly to increase in its severity. Practically the only institution to call any public attention to the matter was the Federal Reserve Bank of New York which eventually adverted to the subject in its monthly review of business conditions, noting the fact that speculation had apparently attained a powerful hold upon the community. It was indeed a dangerous situation which had grown up in New York. Many banks in that city had become heavily indebted to the reserve bank with government securities as collateral, while their funds had become deeply involved in operations of any equally speculative nature, connected with foreign trade and with other enterprises which had received a rather undue expansion in scope.

Controversy as to Rates

The result of these conditions was of course to bring about a very sharp division of opinion with respect to rates, one section of the community advocating a higher rate policy, while

another section was strongly of the opinion that "prosperity" was dependent upon the continuance of conditions substantially as they then stood, and without any material change which might operate to cut down the growth of prices. An acrid correspondence developed between sundry of the reserve bankers and the Board at Washington, as well as between the treasury authorities and the reserve banks. In fact, this controversy was at one time carried to a point which threatened to result in the resignation of one or more governors of reserve banks under pressure from the Treasury Department. As the year advanced, the Treasury came more and more to entertain the view that proper restriction of credit was entirely possible in the several reserve districts if the banks there would consent to the exercise of a far greater power of discrimination in loans, refusing to advance funds when certain that such funds would be used to carry or promote speculation.

The difference of opinion reached an acute stage late in 1919, when Secretary Glass made demand upon governors of reserve banks that they reduce their speculative loan commitments and insist that their members do likewise. This he thought an urgent and essential preliminary—preceding the proposed advance of rates which would, of course, penalize the community at large.

Reserve banks, on the other hand, generally maintained that they had no such power of discrimination, but that they were called upon to discount equitably for all member banks alike, at the rates which the Board had fixed. To their minds, therefore, an advance in discount rates was absolutely essential as a prerequisite to the restriction of credit. Such an advance they, in various cases, desired to make, but found themselves restrained from so doing by reason of the refusal of the Federal Reserve Board or the Treasury, or both, to permit any alteration of the rate situation in its bearing upon Treasury paper. The problem received thoughtful discussion and attention at the conferences of governors held during

1919, as well as at the meetings of the Advisory Council, and the latter body went on record with respect to its opinions in the matter, transmitting to the board the following answers to questions bearing upon public finance and its management

You have asked our advice as to the discount rates current at the Federal Reserve Banks, particularly as they are affected by the amount of Government issues remaining undigested, as evidenced by the fact that the larger part of the invested assets of the Federal Reserve Banks consists of member banks' 15-day notes secured by Liberty Bonds and Treasury Certificates and of customers' notes maturing within 90 days secured in like manner. The Board would like the opinion of the council as to the merits of differential rates. Assuming the differentials have been necessary to aid the Treasury in floating its securities, does the council feel that differentials with respect to the character of paper and not to time of maturity should be continued as a permanent policy?

Recommendation—Until the Liberty Bonds already issued and the Victory Bonds to be issued are distributed among permanent investors and paid for by them, and until the banks are relieved of the obligation they are under to carry such large lines of them for their patriotic customers who have gone in debt for them, and until our Government gets through with its temporary financing on short-time certificates, the discount rates at the Federal Reserve Banks should continue to show some preference on loans covered by Government securities. The rates might well be continued as they now are until after the next bond issue has been placed, but there will come a time when such preference should not be continued, otherwise loans on Government securities will continue to form too large a proportion of the Federal Reserve Bank loans to the disadvantage of commercial paper and therefore to the disadvantage of industrial and commercial enterprise. The financial necessities of the Government for the payment of its war debts will, however, have to be met and provided for before such discrimination in favor of loans covered by Government securities as will induce people to borrow to pay for them in anticipation of their future earnings and incomes can be discontinued.

You have asked for the views of the council, as to whether it will be necessary for some time to come, in order to develop an acceptance market in this country, to stimulate it by a low rate at the Federal Reserve Banks, and you have drawn our attention to the lower rates prevailing in London for bankers' acceptances than those current here.

In the opinion of the council, the acceptance market in this country is developing as well as could be expected. The market for bankers' acceptances is now and has been materially interfered with by our Government's financing on certificates of indebtedness. This interference will continue as long as the Government continues its short-time financing. In the meantime, the acceptance rates at the Federal Reserve Banks should be maintained just about as they have been. When conditions again settle down on a peace basis, supply and demand combined with competition in foreign markets will govern such rates.

Attitude of Business Community

The business community, on the other hand, was by no means a unit. Many business men were of the opinion that advance in prices was good for trade and that continuance in the expansion of bank credit insured higher prices. Indeed, not a few of them had become so much addicted to war finance methods that they desired to have the government continue its control of business even longer than it was disposed to do, buying their commodities and paying for them in cash obtained from bank borrowing. The farming community was not directly a participant in this discussion, inasmuch as the northern farmer was still enjoying the benefits of a "pegged" price for wheat, while the southern farmer was still sustained with heavy foreign purchases made with funds borrowed from the United States government. The later myth on the subject represents the farmer as having been led on and encouraged by excessive advances of government credit during this period, but any such interpretation is of course imaginative. The truth is that the farmer was largely independent of the credit situation at the time, and did not need to trouble himself about it. The demand for his products was good, prices were high, and he was able to get cash. He accordingly sold for cash and his speculations in land were easily financed by the giving of mortgages. Thus he more and more tended to avail himself of the general expansive tendencies

of the time without considering the question where this indulgence would eventually lead

Growth of Prices

As the year 1919 advanced, facts which had not been expected made their appearance. Among these was the steady and rapid growth of prices. For a little while after the conclusion of the armistice, prices had hesitated. Business men had doubted whether demand for their products would continue good or not. Some had feared a reaction, others that the government would dump upon the market its entire supply of stored products, accumulated for use by the army. These fears were not realized, and after January, 1919, the upward movement of prices was continued so that during the first nine months of the year the advance in the wholesale index was from about 203 to 223. This increase in prices was of course the outgrowth of the great upward swing of business and of speculative demand, coupled with the free system of credit at the banks and the fact that almost anyone could finance transactions which implied the purchase of commodities for future use.

Thus the business world tended to move more and more rapidly forward, the inflation steadily reflected in prices requiring the increase of bank credit, while the growth of bank credit in turn reacted upon the inflation, with the familiar results always realized under such conditions. As later appeared, much of the harm that was being done was in connection with foreign trade (see Chapter LVIII), but for the moment very little attention was paid to that side of the matter. Both the Board and the Treasury Department were primarily concerned in domestic business finance, and were chiefly anxious about the influence produced by it upon such questions as speculation and the conditions associated therewith. As to these, the steadily rising price level afforded ample ground for anxiety—a fact which was recognized by

the Board in statements published by it from time to time as well as in authoritative letters sent to inquirers

Increase in Production

At the time, it was apparently thought by some that inflation was not particularly harmful because it was accompanied by an active increase in the production of real wealth. Whatever weight might in other circumstances have been given to such a view, it was not entitled to very serious consideration in 1919. As will be seen in a later chapter, a large part of the great production was being given away, in effect, through exportation to countries which were unable to pay for it, while another large part was being stored or hoarded because it had been produced far in advance of the time when it was likely to be wanted. It therefore represented nothing more than a conversion of productive sources and factors into goods not yet available for public consumption or for which, at all events, there was no real or genuine demand, owing to the fact that consumers generally were unable to buy because the price level had outrun their purchasing power. These aspects of the situation were, however, only gradually accepted and perhaps never were accepted by the rank and file of government officials who were largely responsible for the inflation policy. Secretary Glass became more and more keenly aware of them as the year advanced and more and more desirous to see a return to normal conditions in rates of discount. This, however, was a matter which involved very serious difficulties, for reasons which must be considered more at length in later chapters.

CHAPTER LVIII

FINANCING FOREIGN TRADE

Relation to War Finance

No account of the post-armistice history of the federal reserve system would be understandable without at least a review of the effort to develop and to finance foreign trade upon a gigantic scale. Former wars have brought their own consequences in the way of financial retribution. Direction has usually been given to it by the peculiar conditions of economic development produced during such war periods. During the European war, the most striking alteration in American economic life was the sudden preponderance in importance of American foreign trade and the conversion of the country from a debtor to a creditor status. Not only was our foreign indebtedness largely wiped out, but we acquired a vast control over other countries by reason of the immense size of the advances we made to them. Inasmuch as these advances were largely in the form of consumable goods, they represented a very large expansion of productive power in certain industries. Some such industries were estimated by their operators as having increased their productive plant during the war by perhaps 20 per cent of its original amount.

Growth of Trade

It was, therefore, quite in line with past experience and with the trend of economic development that the direction of post-war business growth should be toward the continued expansion and evolution of foreign trade. This was materially assisted by several sets of factors. In the first place, the Treasury Department continued to extend enormous amounts

of credit after the war was over to foreign governments, the total so advanced being more than \$2,500,000,000. Secondly, the fact that during the war our manufacturers and exporters had practically been guaranteed in their shipments by reason of the "pegging" of exchange and in other ways, had relaxed their caution, and they continued to sell freely to foreign countries at exorbitant prices and without any assurance of being able to collect the sums due them. Our banks, moreover, continued to extend large credits, while those which had established branches abroad in some cases gave to such branches almost unrestricted powers of credit expansion and ability to make loans. The result was to produce a tremendously top-heavy and insecure structure of foreign credit. This ought by every dictate of sound banking to have been carefully cut back or restrained as soon as the war was over. As has been seen, however, the federal reserve system had religiously abstained from participating in any foreign application of the powers of the system and was apparently ignoring their existence. It neither possessed much of a portfolio of foreign bills stated in dollars, nor did it hold any bills stated in other currencies. It had no foothold in any foreign market and little or no power to control its members in their foreign operations.

Danger Foreshadowed

The danger growing out of this situation was early foreshadowed by careful observers. Already, as we have seen, attempt had been made within the system to secure a definite participation in the financing of foreign trade, but the idea had been rejected by the Federal Reserve Board and by the reserve banks. When the system of pegging exchange was discontinued in the middle of March, 1919, it was reasonable to expect a very decisive reaction in exchange values. This did not immediately develop in full force, for the well-known reason that banks and others had made exchange contracts that

would carry them over for some time past the date when official pegging was suspended, while on the other hand the bills which they were carrying did not mature for some weeks, so that it would have been unreasonable to expect any very immediate or early alteration of conditions. It was obvious, however, that this state of things could not last long and that when it came to an end there would be severe reaction, with losses in the value of foreign bills and probable contraction in the value of assets held by foreign branches. So far as can be discovered, however, no effort was made on the part of the banking community to guard against this condition of affairs except that of, so far as practicable, shifting the responsibility or liability by retaining a recourse upon the exporter in such a way as to be able to collect from him in the event that his foreign debtor did not settle with him. This, it was assumed, would enable the banks to protect themselves in the event of loss, and probably would have done so had the erroneous foreign financing been restricted to a limited number of concerns. The trouble was that it had assumed the proportions of a national evil and had gone so far that when difficulty ensued it was out of the question to attempt to apply in any rigid way the methods of protection which had thus been devised. Had they been so applied, they simply would have failed, and widespread bankruptcy would have been the result without benefit to the banks of the country.

Views of Federal Reserve Board

Nevertheless, the situation was such as to arouse anxiety on the part of the Federal Reserve Board, and by the middle of 1919 the problem of providing a definite means of financing foreign trade which would take the strain off the banks and would at the same time furnish a more satisfactory basis for future trade, was under advisement. The subject was taken up with various conferences of bankers but doubts and fears then expressed received no very serious attention. The bankers

expressed the opinion that the banking community was entirely capable of taking care of itself. Not satisfied with this, however, the Board proceeded to develop and place before Congress a measure intended to correct the situation and provide a means of foreign financing. This was the so-called Edge Act which made its appearance in a full-fledged form during the summer of 1919. The conditions which produced the Edge Act require some analysis prior to a review of its provisions in more detail¹.

Financial Conditions Abroad

Studies of financial and banking conditions in the principal European countries showed that the currency and banking situation on the Continent was one of unusual difficulty, while it appeared that supplies of available capital had been reduced to a minimum basis. It did not seem probable that conditions in these foreign countries could be promptly restored to a normal footing without importing from abroad in very large measure the funds that were needed in the process of financial rehabilitation. In this connection the question was pertinently raised what would be the effects of the reparation which was to be made by the Central Powers as a result of the peace settlement. This reparation would of course operate to create a one-sided balance of trade in goods, ships, and forms of capital, as well as of securities, between the Central Powers and the countries with which they transacted business. It would therefore tend to place the recipients of the reparation in possession of funds with which they might liquidate their obligations to their own citizens or to foreign countries.

France, Belgium, and other continental nations were heavily indebted to Great Britain as well as to the United States, while Great Britain likewise was a heavy debtor of this country. The reparation payments, while to be passed through the

¹ The following pages (1310 to 1314) present such an analysis, substantially based upon material prepared for the Federal Reserve Board by the author, and printed in Federal Reserve Bulletin, June, 1919, pp. 525 ff.

countries which were their recipients, might thus in the last analysis furnish the basis for payments to the United States designed to liquidate the advances made by this country to cover the cost of the war, save in so far as American investors might prefer to leave their funds actually at work abroad. In the latter case the effect of the reparation payment would be merely that of converting a government obligation into private securities or other evidences of indebtedness. Belgium's share of the reparation had already been used as security for the advance made by a group of American banks under the so-called Belgian Industrial Credit, and it was expected that other loans or accommodations of the same or similar kinds would take place in the near future. It would, however, be some time before the reparation thus paid could, in fact, amount to more than a fraction of the sums needed to re-establish industry abroad upon anything like its pre-war basis. The problem of importing capital into practically all of the European countries was thus a continuing one, and a successful basis for such importation could be found only in the assurance to individual investors in this and in other countries which had a surplus of savings for current requirements that there was a better field for the use of such savings abroad than at home. It was a problem of continuous rather than of temporary financing, and had reference to the ability of foreign countries to produce income through investment rather than to produce immediately consumable goods for the purpose of re-establishing their merchandise balance.

Foreign Exchange Developments

During the month of May, 1919, the foreign exchange situation continued to become more difficult than it appeared to be immediately after the period of "pegging" which came to a close on March 18. An immediate indication of difficulty in this connection had been afforded by a sharp decline in quotations for the principal foreign currencies, sterling going

as low as \$4 63, francs to 6 77 per dollar, and lire to 8 75. These figures constituted record low quotations for francs and lire, and while the quotation for sterling was not so low as those made after the close of the pegging, it was lower than the rates which prevailed at the close of April. French currency was worth little more than three-quarters of its face value as expressed in terms of American dollars.

The immediate causes of this condition of affairs were obvious. It was reasonably estimated that the trade balance of the United States during the fiscal year ending June 30, 1919, would be about \$3,000,000,000, or practically the sum that had been annually recorded for the past three years. The interest due and payable on our holdings of foreign securities was not much below \$500,000,000 annually. While it was impossible to say what were the total amounts payable to American citizens who were owners of foreign securities, or who had advanced sums for use in foreign countries upon which they received regular returns, it could be conservatively estimated at \$100,000,000. Unofficial figures for the amount of foreign obligations maturing in the United States during the calendar year 1919 placed that sum at possibly \$600,000,000 to \$750,000,000. If the figures thus given, partly for the calendar year and partly for the fiscal year then drawing to a close, be regarded, as they reasonably could, as applicable to conditions for the calendar year, it was apparent that means would have to be found during 1919 for the financing of about \$3,600,000,000 of new obligations and for the renewal of perhaps \$600,000,000 old ones.

This made a gigantic, probably an unprecedented, financial problem. The Treasury's ability to advance sums to foreign countries had been limited by Congress to the sum of \$10,000,000,000, of which about \$9,500,000,000 had been taken up. The department had therefore at most a sum of \$500,000,000 (most of it allocated) which could be used for this purpose, so that it would seem that probably much more

than \$3,000,000,000 of new funds must be provided by private initiative if we were to continue our export trade upon its existing level. It should be recalled that, as already mentioned, Congress had provided an export credit of \$1,000,000,000 which might be made available through the War Finance Corporation. The doubt whether our export trade could be continued upon its existing level without involving serious financial strain made the question of our national policy in reference to such trade one of urgent concern for the whole community.

Export Trade and Prices

The primary effect of the great exportation of goods from the United States was twofold—that of keeping fields, factories, and men employed, and disposing of their product, on the one hand, and on the other, that of maintaining prices. A slackening of the export trade would mean an increased consumption of goods at home or else a lessened production of them. The constant assumption was that the latter of the two alternatives would be the one to be pursued and that accordingly a reduction of exports from the United States would mean a limitation of prices in this country. Shortened industry, less demand for labor, and accordingly falling prices, would be the net result of such a change in the direction of our business. For this reason many business men and financiers evidently regarded the maintenance of a great export balance as practically essential, the chief modification which they seemed to wish to make in it being that of substituting manufactures for a part of the agricultural products which we were shipping abroad. It was for the attainment of this end, and incidentally that of selling these exports at practically the prices prevailing, that much of the theorizing and most of the practical expedients that were suggested in prevailing discussion of our international position were intended.

This left untouched, however, the possible alternative that

even if export trade should be less active, there might be developed an equal demand for our goods in domestic trade which would result in employing our labor and capital at practically the same rate. The question was really reducible to this—whether we were to use all such new capital as might become available through savings above what was requisite to absorb undigested Liberty loan bonds for the purpose of developing our own natural resources and expanding our own industries, or whether a considerable part of it was to be loaned for use in European fields of investment naturally less productive but for the time being offering large returns, because of the necessities in which the peoples of Europe found themselves at the close of a war of economic exhaustion. Should it be true that we could to greater advantage use all our capital at home, the only consideration in favor of an attempt to maintain export trade at its present level would be that such assistance to foreign countries had not only an economic bearing, but also a broader aspect. This aspect would be found in the view put forward by some that there was a motive of self-interest as well as of altruism underlying the idea of assisting foreign countries rapidly to restore their productive capacity and to get back into sound economic condition.

Domestic Investment Field

Economically speaking, the question of maintaining our export trade by means of loans and advances thus reduced itself to the problem whether there was a better field at home than abroad for the use of new capital. It was undoubtedly true that many industries in the United States were still retarded and still feeling the effects of the war which operated to reduce their access to capital. The building trades had suffered severely and both commercial and domestic construction had fallen far behind their natural ratio of advance during the preceding four years. Municipal utilities and public utili-

ties generally had been feeling the difficulty of securing sufficient capital for adequate expansion, due to lack of confidence in their ability to earn at existing rates. New industrial opportunities had not presented themselves with their accustomed speed, and only in a comparatively few industries whose work was largely contributory to the waging of the war could it be said that there had been a sufficient stimulus to development. This situation was evidenced by the high rates of interest which many industries stood ready to pay for the obtaining of capital in the present market. Assuming that foreign countries were in position to pay equally high rates, the question of the use of our available loan funds would be determined by the views entertained by business men and experts concerning the probable earning power of the industries of those countries. A reduction in our export trade would necessitate some readjustment of conditions or relationships such as that which followed the armistice, but the transition could undoubtedly be effected. Existing exportations were unquestionably upon a basis which it would be difficult to maintain as a permanency, inasmuch as they were so far above the pre-war level.

Position of Banks in Foreign Financing

Pending a decision of these large questions, American banks were doubtless in a somewhat embarrassing position. Their managers naturally did not care to place themselves in a situation in which they would own large balances abroad unless some definite provision was made for continuously financing the export balance. Accordingly, many conservative bankers were "covering" or "hedging" their discounts and purchases of foreign bills, refusing to discount or buy until they had sold a corresponding amount of the foreign currency which was to result from the paper offered them when such paper had matured. The effect of this policy, of course, was to reduce or limit the holdings of foreign currency by American banks, or, in other words, to require such foreign countries in every case

to provide for the liquidation of their purchases before they were actually able to finance them in the United States. In former times such a tendency would have afforded a sharp check to their purchases of American goods, but as things stood the disposition of foreign countries to buy upon long-term credit instead of providing themselves with means to liquidate this credit within an ordinary period through the exportation of their own goods or gold, would shortly reach a point at which the disparity of values between our own and foreign currencies would become so great as seriously to handicap further business. Alternative to this conclusion, or as an expedient which would probably be resorted to before any such final outcome had been arrived at, was the possibility that more gold might be shipped to the United States by debtor countries, thereby tending still further to raise prices here and to maintain them upon some basis of parity with the level existing abroad.

Call for Government Aid

In this situation it was not unnatural that some important private interests had been calling for government aid in supporting exchange and in the extension of credits for export business. Congress had already declined to increase the powers of the Treasury Department with respect to direct loans to be made to foreign countries, and it remained to be seen how far the credit of one billion dollars placed within the reach of the War Finance Corporation could be availed of in practice. Whatever might be determined on that score, it was not desirable that government direction of private industry should be continued longer than absolutely essential. When a foreign country obtained an advance from the government of the United States and then spent the funds thus allotted it in the purchase of American goods for exportation to its own citizens, there was practically a joint government guaranty of

either private consumption or private manufacture, or of both, with the results which usually follow from such guaranties

These results might be considered embodied in a tendency to indiscriminate consumption and more or less uneconomic use of the funds or goods which are thus set apart for the promotion of national development. A time would inevitably arrive when the emergency would no longer be such as to require national borrowing in behalf of private individuals, and when to continue this policy of subsidy or public support practically would result in the increase of an indebtedness which was passing beyond the power of the debtors to liquidate. Our banking organization was capable of safeguarding the country against undue devotion of its funds to foreign development should such tendencies manifest themselves, and at the same time of avoiding unwise withholding of support which comes from a lack of vision or a failure to understand the ultimate results of the refusal of present accommodation. This, of course, still left open the question of the precise means by which our bankers and exporters could thus protect themselves. But it was understood that the problem was now fully under consideration and reasonable provision for the needs of the future might accordingly be expected.

Prices and Banking

As has been stated, the overgrowth of our export trade had undoubtedly had a powerful effect in preventing a decline of prices. This was due not only to the actual subtraction of goods from our domestic market to the extent that our exports were sold on long-term credits, but also to the more subtle and less obvious influence produced through the general continuation of inflation. To this perhaps more than to any other current factor might be ascribed the fact that prices had again turned upward. It had been supposed in some quarters that, as the demands of the government for the financing of war expenditures grew less, and as the demands of private business men and bankers for the financing of industrial enterprises

grew more, there would be a distinct check to inflation and a definite tendency toward restriction of prices

This would normally have been true had bank credit been confined to a strictly banking (i.e., short-term) basis. When, however, advances on the part of banks took the form of practically long-term or investment credit, their influence was to withdraw commodities from the market and to permit the use of them either for consumption or for the creation of investment capital whose actual power to produce an income return was necessarily rather far in the future. Such advances on the part of banks inevitably tended to maintain prices, and when such loans were made for the purpose of facilitating or carrying on export trade which had produced a steady and "favorable" balance (that is to say, a condition showing far greater exports than imports of merchandise), the influence upon banking conditions was very similar to that created through the use of bank funds for the support of public credit. In the present circumstances, therefore, a continuous excess of exports over imports, paid for by the issue of long-term obligations more or less largely sustained by the banks, had to be regarded as a distinct factor tending to maintain the existing inflation and to keep things upon an unduly expanded basis.

The foreign banking institutions were already meeting the same problem, and it was under discussion in a number of countries, notably Great Britain, where the continued large importation of commodities purely for purposes of personal consumption was being discouraged so far as practicable. Nevertheless, the reaction of feeling resulting from the close of the war had unquestionably tended to increase the disposition of individuals to buy and spend with comparatively little regard for the eventual results of their action. Possibly the most important immediate outcome of this condition of affairs was the overstimulation of retail trade in consumable commodities and especially in luxuries, and the relative retardation of business in basic commodities and materials for manufac-

ture The existence of this state of things was very obvious, not only abroad, but in the United States

The Edge Act

The Edge Act was based upon the idea of keeping undesirable long-term foreign paper out of the federal reserve banks by providing a special set of institutions whose duty it would be to finance foreign trade, and by taking and holding such paper to afford a basis for the business, while at the same time drawing in from all possible resources the investment or semi-investment funds which the public might be willing to devote to this purpose. It was bottomed to some extent upon the War Finance Corporation, although it borrowed largely from the so-called "investment trusts" of European countries. Under it there would have been created, had it ever come fully into being, two distinct classes of corporations. One would have made acceptances and dealt in relatively short-term paper, running to, say, a year or more, such paper being "short" only in comparison with the operations of the other or second type of Edge Act banks. In this second type the institution would have taken over securities representing long-term advances to foreign countries and to other industries, would have placed these bonds in a pool as a trust fund to protect an issue of debentures, and then would have sold these debentures.

The two kinds of business were essentially different, the former class being distinctly of the so-called "intermediate credit" variety, the second being definitely an investment business. It was undoubtedly a mistake to try to associate the two things together in the act and, as experience speedily showed, there was no basis or demand for any such measure in any event. The public was not particularly concerned in the financing of foreign trade. A group of manufacturers were so interested and they were already being called upon by the banks to guarantee the credit of foreign buyers. They were, however, not particularly ready to transfer this guaranty to a

separate type of institutions by purchasing the stock or bonds thereof, while the public certainly was in no humor to do it, and interest rates were such that the average owner of a small sum of money could, easily enough, get 7 or 8 per cent with a fair degree of security on an industrial investment. There was no reason why he should take the bonds of an Edge Act corporation at any lower figure and so in order to get his money a higher one would doubtless have to be offered by such a corporation. A rate of 8 to 10 per cent on industrial bonds would, of course, have meant 10 to 12 per cent to the foreign user of the capital, and this was likely to be very nearly prohibitive. The Edge Act entirely misconceived the needs of the foreign situation. There was no reason why abundant capital should not have been obtained by financiers through existing methods of financing, the trouble lay in getting to any sound basis for financing abroad. If no sound basis could be provided domestically, an Edge Act corporation could not supply it. Indeed, soon after the war it became evident that large lenders in this country wanted the guaranty of foreign governments and nothing less. Having that, they were about as well off as with bonds of an Edge Act corporation.

Although the Edge Act was widely advertised and almost universally praised, it met with no success. Institutions of rather low capitalization were created² and undertook an acceptance and long-term foreign credit business. An effort was made by the American Bankers Association, and interests affiliated with it, to create a \$100,000,000 corporation of the debenture type, but the effort did not succeed. After a few months of discussion and advertising, the notion was abandoned. There was no further organization of Edge Act corporations, and the one or two which survived found it difficult to get more than an adequate amount of business to keep themselves going and pay expenses and dividends. The effort to afford a new type of foreign financing disconnected

² One in New York, a later one in New Orleans and another in Alabama.

with the federal reserve system, save in so far as its acceptances might be bought by the reserve banks, had proved a complete failure, and the system was still as much isolated from foreign affairs as ever, while its members were subject to as great danger as ever in connection with their foreign financing

Growth and Recognition of Dangers

The recognition of these grave dangers was not, however, immediate. Not very many bankers or business men had realized the extreme hazard which might be incurred as a result of operations that continuously developed a credit balance in favor of the United States which foreign countries had no means of settling. Lacking a central banking provision which would have tended to co-ordinate foreign sales and transactions, business men and bankers had pressed forward independently without much reference to the effect of their aggregate effort. The consequence was to develop an enormous credit balance in favor of the United States. Foreign buyers possibly did not themselves realize how heavily into debt they were going, and the result was that they became greatly overloaded and placed themselves in a position in which the slightest recession of prices would make it impossible for them to settle. Toward the close of the year 1919, this state of things was reaching a most aggravated position and not a few bankers recognized that a crash was undoubtedly imminent. There began to be widespread doubt and fear. Many persons expressed the opinion that the federal reserve system was very efficient in promoting inflation but that it obviously had no power to bring about contraction or deflation. What would be the result of the enormous overexpansion of foreign trade with the development of the immense unfunded balance of debt was the constant subject of debate and controversy, while the responsibilities of the reserve system in these circumstances were fully recognized in Washington but nothing material was done to comply with them.

CHAPTER LIX

RESUMPTION OF CONTROL OF DISCOUNT RATES¹

As has been seen in Chapter LVII, a hazardous condition had developed in domestic speculative markets. Similarly hazardous conditions had, as just seen in Chapter LVIII, been involved in foreign trade. The two situations together combined to produce upon the mind of the Federal Reserve Board the conviction that something must be done to resume control of the credit situation or to develop such control to a point that had never before been attained.

Final returns for the Victory Liberty Loan, as compiled by the Treasury Department, showed that the aggregate subscriptions amounted to \$5,249,908,300, while the total number of subscribers receiving notes of the new issue was approximately 12,000,000. The outcome of the Fifth Loan, as thus indicated, was therefore an appropriate conclusion to a great and probably unprecedented series of government offerings. The actual loans placed by the government since it became a belligerent, with the number of subscribers and amounts accepted, were at the time summarized thus:

Loans	Estimated number of subscribers	Amount allotted
First loan	4,000,000	\$ 1,989,456,650
Second loan	9,400,000	3,807,891,900
Third loan	18,376,815	4,176,516,850
Fourth loan	21,000,000	6,992,927,100
Fifth loan (preliminary estimate)	12,000,000	4,500,000,000
Total		\$21,466,792,500

¹ The situation in 1919, as outlined on pp. 1321-1328, was discussed by the author in a statement prepared for the Federal Reserve Board and published in Bulletin, June, 1919, pp. 522 ff.

The Victory Liberty Loan simply sufficed to fund the greater part of the outstanding certificates of indebtedness into bonds. It therefore in no respect changed the problem of contemporary borrowing by which the Treasury was necessarily faced. Expenditures were running, eight months after the armistice, at about the rate of \$1,100,000,000 per month. On May 1, the Treasury Department had placed another issue of certificates of indebtedness amounting to \$591,300,000, and it was understood that further issues would necessarily have to be offered to the public from time to time in order to make up the difference between current receipts from ordinary sources of revenue and the outlays on the basis just sketched. The obvious method of obtaining these funds currently was that of continuing to place issues of certificates with the banks. Such issues, however, had in the past been based upon the plan of periodically selling an issue of Liberty bonds. Since this plan was now definitely terminated the change in public finance thereby rendered necessary would be that of providing a new method of funding the certificates from time to time currently sold to the banks. This offered a problem somewhat resembling that of successfully placing the war savings stamp issues. It required effort designed to fix the attention of the investing public upon the needs of the government and at the same time to offer a security which furnished a reasonable amount of remuneration and into which, therefore, the savings of the community might be expected to flow. Thus again was presented the necessity of enlarging the savings of the community and of devoting these savings to the absorption of government securities, a duty which was strongly insisted upon during the continuance of hostilities, but which none the less today exists in as acute a form as it did then. Financially, the war was by no means over.

A Period of Reconstruction

The economic problem before the country of which these

phases of war financing formed a part involved two issues. One was the question how to proceed in meeting the needs of domestic growth. The other was that of establishing the proper balance between our own progress toward a new economic adjustment and that which we might assist European countries to bring about through aid to be extended to them. A proper settlement of these two questions in their relation to one another involved a process whereby price levels in all countries would automatically work toward a new basis, and implied also the establishment of a new rate of return to capital which might probably show a greater approach to uniformity than previously attained. Not to establish a working community of prices, values, and rates of yield on investment would have meant that interchange of goods and of investment funds among nations would meet with difficulty. The situation of the world was such that for some time there would be a marked reduction of the differences between the economic systems of the leading countries. It was certainly not to the interest of any nation that other nations with which it had close relations should be seriously retarded in the legitimate use of resources and in the proportionate employment of labor.

The attention of the people of the United States had naturally been focused upon the further improvement and expansion of domestic industry, but the position of the country when considered from a world standpoint showed that such expansion involved for its fullest success expansion elsewhere, both in order that customary markets for sale and purchase might continue to exist for domestic products, and in order that foreigners might be enabled to liquidate in due time their obligations to American creditors growing out of advances made to them in the past and those necessarily to be made to them in the future. The continuation of such advances accordingly implied that such foreign countries should be helped to attain to a condition in which they might settle their indebtedness by the shipment of goods—a means of

liquidation which they could not successfully employ unless they were enabled to place themselves in a productive condition. Our banking and financial organization thus had a new and important function to perform—more important and responsible than any it had been called upon to perform in the past—that of determining the division of capital in the international field, just as it had previously been one of its principal functions to determine the division of capital within our own territory and within different fields of industry. The banking system of no country has ever been confronted with a greater or more serious responsibility. For the disposition that is made of our financial resources will affect everyone in the country for better or for worse, either as a consumer or as a producer.

Growth of Business Activity

Apparently, in consequence of the further progress toward peaceful conditions and a stable price outlook, as well as the elimination of the artificial conditions which existed during the war, there was evident a continuous growth toward the restoration of private business activity to a more normal level. Conditions during the autumn of 1919 more than ever favored this renewed trend toward activity and efficiency. The excellent agricultural outlook had undoubtedly contributed in no small degree to the development of an optimistic attitude on the part of business men and bankers, while a belief that further reductions in prices were not to be expected in the near future had had a considerable share in encouraging construction and manufacture. The re-entry of the railroad administration into the market as a large buyer of iron and steel was expected to have an important effect upon private demand for those articles, while a rise in the price of copper and other basic metals was already observable. It still remained true that the steel industry as well as other fundamental lines of manufacture was far below the normal level of production. Building

operations were, however, resuming in a number of important directions and there was some increase in the volume of railway tonnage, which had been reduced to a relatively low level during the early months of the year. The strong foreign demand for American products resulted in keeping up the activity in shipping, although vessels had difficulty in obtaining return cargoes from European ports to the United States.

This resumption of business activity necessarily meant a considerable increase in demands for loans and discounts at banks of all classes, an increase in demand to which bankers made a ready response. Partly as a result of these conditions and partly, as will later be noted, in consequence of strong foreign demands for shipments of goods produced in the United States, the general trend of prices was upward. The Board's index number showed that there was an advance during the month of April of about three points, and the reports of the Federal Reserve agents indicated that this upward movement did not only not cease but was on the increase.

End of Government Control

Significant developments had also occurred in connection with the progressive elimination of government control from business. Possibly the most important administrative development in this connection had been the abandonment of the attempt of the government and the steel producers to find a working basis for price revision in that industry with the presumed result of establishing an open steel market. Another important step had been the removal of import restrictions by Great Britain, such removal restoring to a condition of unrestricted movement the long list of articles whose importations had previously been barred. The President's message presented to Congress on May 20 fixed a definite limit for the return of the railroads to their owners, and indicated that the return of the telegraph and telephone systems would take place as soon as practicable. Numerous minor restric-

tions upon business had been eliminated during the spring and it was probable that there was by mid-year a greater degree of freedom of movement and lack of restrictions upon trade throughout the world than had existed for nearly five years

The restoration of business to a competitive basis necessarily implied the restoration of the banking and financial mechanism to the exercise of its normal functions in connection with the development of trade. Among these were the restriction of undesirable or excessive borrowing and the application within reasonable periods of the test of liquidation to our foreign trade. It would probably be some time before the mechanism recovered its full effectiveness and was able in the same degree as formerly to adjust the relationships of demand and supply and to control undue fluctuations in prices. During this period of transition danger of maladjustment or inflation would necessarily exist in greater or less degree, and such safeguards as could reasonably be applied needed to be invoked. This placed upon the banks of the country an exceptionally responsible task.

A Speculative Era

One phase of the present situation which paralleled conditions that had existed at the close of most former wars was the development of an active speculative situation in the securities market. Operations on the New York Stock Exchange had reached a basis practically unprecedented since the opening of the war and paralleled only by the active market operations which marked the advent of large munitions orders when the European contest had definitely established itself. A succession of "million-share days" with abnormally high prices in many classes of goods, had indicated the scope of the speculative movement itself, while the fact that much of the buying was said to have come not from professional traders but from prospective investors throughout the country, indicated the hold which the movement was already taking upon the popu-

lation of the United States. One phenomenon which had presented itself as an incident to this speculative movement was the existence of high call money rates. These rates had at times gone as high as $7\frac{1}{2}$ per cent, although only for a short period in any instance. Such fluctuations of the call-money rate had promptly been followed by little more than very moderate curtailment of the volume of banking accommodations.

There was thus undoubtedly an element of danger to the financial position of the country. Ordinarily a sharp check could be administered through the advancing of rates of rediscount at federal reserve banks. Such a check for the moment encountered some difficulty so long as the policy of promoting the absorption of government securities by favoring rates was maintained. For the moment the avoidance of abnormally high loan accounts had to be effected by means other than those which would ordinarily be applied under the methods and principles of central banking. Eventually, when circumstances permitted, and the federal reserve banks assumed their normal functions, making advances chiefly against liquid commercial paper and reducing to small proportions advances against United States government collateral, a natural and effective check to existing conditions in the money market might be afforded through changes in rates at federal reserve banks. As things stood, the continuance of emergency conditions caused by the war induced this primary function of the federal reserve system to be held more or less in abeyance.

Short Supply of Capital

That the supply of capital for meeting the manifold requirements of reviving business and foreign trade was distinctly deficient, was a view already widely accepted. Just how deficient this capital supply was, had not been fully known, indeed, could not be until the necessities and requirements of the several countries had become better recognized and estab-

lished The few months after the armistice had shown that their needs were far greater than had been supposed and that very great sums could be used to advantage if they could be obtained on a satisfactory basis European countries did not, of course, afford a virgin field of investment, but the restoration of industry and trade in Europe was so important to the whole world in an economic sense, and was so desirable in other than commercial ways, that the field of investment offered by Europe might in a practical sense for the time being be regarded as tantamount to a new field The economic scheme of the world would be out of balance and adjustment until Europe's economic power was measurably restored

The United States, however, like every other country, had to consider carefully what was the maximum amount with which it could reasonably part An advance of long-term credit meant the taking of capital and hence of goods from the American market The attempt of our financial system to advance credit at a rate more rapid than justified by the rate of saving would, therefore, simply mean advance in the "cost of living" to the average consumer through a further aggravation of existing conditions of inflation in banking and credit, with harm not only to ourselves but also to those who received advances on an unreasonably high basis of valuation The natural tendency of the time was to attempt to accomplish too much in a short time and to go beyond the natural limits set by available resources, thus overstraining and crippling the investment mechanism of the country and opening at least the possibility of serious danger as a result The difficulty in the situation was rendered more complex by the fact that American investors had in the past been so little used to judging and absorbing foreign securities

Inflation Continued

Continuous inflation of prices, credit, and speculation prevailed throughout the year 1919 The temporary hesitation

which had succeeded the armistice had been speedily followed by strong upward movements in all branches of business and prices, and these were accompanied by enormous increases in federal reserve notes as well as in deposits outstanding. The outcome was to leave the speculative community largely free to do as it pleased, so that toward the close of 1919 matters were rushing forward toward a climax. The high-water mark in stock-brokers' loans in New York was presumed to have been reached at about the close of the autumn of 1919, and it was finally admitted that the practice of drawing heavily upon reserve banks through the rediscounting of Liberty bond-secured paper could be checked only by the application of a new and far more stringent control of discount rates than any that had thus far been attempted, as well as by determined effort generally to discourage the discounting of Liberty bond paper.

Accordingly, the Federal Reserve Board set before itself the attainment of two principal objects—the first, the abolition of the preferential rate designed to favor paper secured by Liberty bonds or Treasury notes, the other, the raising of the rates of discount all around to higher levels. Of the two the former seemed to be the easier to accomplish at the outset and was therefore first attempted, the intention being to drive Liberty bond paper, so far as practicable, out of reserve banks and thereby to restore their liquid character, at least in so far as circumstances would at all permit. This program evidently could not be carried through to successful effect at one stroke of the pen. It would manifestly require a number of months for its consummation and called for joint and skilful effort to reduce inflation in all branches of trade. Increase of discount rates at the end of 1919 was therefore looked upon as merely the first step in a large program, and the Board allowed it informally to be known that what had already been done was by no means final.

Action Finally Taken²

Secretary Glass eventually assented to higher rates. Advances took effect in November, 1919, and gave the signal for a shrinkage of stock market values, which was stigmatized by some unsuccessful speculators as the "Federal Reserve Board panic." The remedy was urgently needed but came too late to act as a corrective.

On the basis of Treasury daily statements, the total gross debt, which on June 30, 1919, amounted to \$25,484,506,160, and on August 31, 1919, had reached the peak at \$26,596,701,648, had been reduced by September 30 by more than \$400,000,000. Notwithstanding the increase resulting from the Victory Loan instalment payments in October and November, when the final payment was made, it stood on November 29 at \$26,116,051,952, a net reduction of about \$480,000,000 from the high mark at the end of August, and a net increase since June 30 of only \$631,545,792, although in that period only one quarterly income and profits tax instalment had been received. The total amount of loan certificates outstanding and unmatured, which on June 30 was \$2,478,317,500 and on August 31 \$2,012,387,500, was reduced in September to \$1,634,671,500, while the total amount of tax certificates outstanding and unmatured, which on June 30 was \$789,561,000 and on August 31 was \$1,925,837,500, was reduced in September to \$1,827,586,500. Of the latter, certificates to the amount of \$746,869,500 matured December 15, 1919, and were amply provided for by the income and profits tax instalment payable on that date.

During the period of five months from June 6 (when holdings of Victory notes were first reported separately) to November 7, all reporting member banks (about 783 member banks in leading cities, which are believed to hold about 40 per

² This description (pages 1330-1338) was prepared by the author for the Board and was first printed in *Federal Reserve Bulletin*, December, 1919, pp. 1106ff.

cent of the commercial bank deposits of the country) had reduced their holdings—

of Liberty Bonds from	\$ 646,273,000	
to	633,950,000	
	<hr/>	
or		\$ 12,323,000
of Victory Notes from	\$ 438,589,000	
to	292,410,000	
	<hr/>	
or		146,179,000
of United States Certificates of		
Indebtedness from	\$1,514,462,000	
to	847,558,000	
	<hr/>	
or		666,904,000
		<hr/>
Making a total reduction in all reporting		
member banks' holdings of United States		
War Securities of		\$825,406,000

The long intermission in the issue of certificates of all kinds made it possible, upon resuming, to issue loan certificates, bearing $4\frac{1}{4}$ per cent interest, and having shorter maturity than those issued heretofore. Coincident with the issue of these loan certificates, it had been thought wise, in order to make it possible and convenient for taxpayers to prepare further for the large tax payments which fell due on March 15, 1920, to offer an issue of $4\frac{1}{4}$ per cent tax certificates of that maturity.

Higher Level of Rates

When in November the federal reserve banks advanced their rates to the extent of about $\frac{1}{2}$ of 1 per cent, the changes made at each bank resulted in the sheet given on the following page

DISCOUNT RATES APPROVED BY THE FEDERAL RESERVE BOARD UP TO NOVEMBER 20, 1919

APPROVED BY THE FEDERAL RESERVE BOARD UP TO NOVEMBER 29, 1919												
Federal Reserve Banks	Discounted bills, including member banks collateral notes, maturing within 15 days secured by—			Discounted bills, maturing within 16 to 90 days secured by—			Trade acceptances** maturing within—		Discounted bills secured otherwise than by Government war obligations† also unsecured maturing within—			
	Treasury certificates of indebtedness bearing interest at—			Liberty bonds and Victory Notes	Treasury certificates of indebtedness bearing interest at—		15 days	16 to 90 days	15 days, including member banks' collateral notes	16 to 60 days	61 to 90 days	91 to 180 days (agricultural and live-stock paper)
	4½ per cent		4½ per cent									
	4½ per cent	4¾ per cent										
Boston	4¼	4½	4½	4½	4½	4½	4½	4½	4¾	4¾	4¾	5
New York	4¼	4½	4½	4½	4½	4½	4½	4½	4¾	4¾	4¾	5
Philadelphia	4¼	4½	4½	4½	4½	4½	4½	4½	4¾	4¾	4¾	5
Cleveland	*4¼	4½	4½	4½	4½	4½	4½	4½	4¾	4¾	4¾	5½
Richmond	4¼	4½	4½	4½	4½	4½	4½	4½	4¾	4¾	4¾	5
Atlanta	4¼	4½	4½	4½	4½	4½	4½	4½	4¾	4¾	4¾	5
Chicago	4¼	4½	4½	4½	4½	4½	4½	4½	4¾	4¾	4¾	5
St. Louis	4¼	4½	4½	4½	4½	4½	4½	4½	4¾	4¾	4¾	5½
Minneapolis	4¼	4½	4½	4½	4½	4½	4½	4½	4¾	4¾	4¾	5½
Kansas City	4¼	4½	4½	4½	4½	4½	4½	4½	4¾	4¾	4¾	5½
Dallas	4¼	4½	4½	4½	4½	4½	4½	4½	4¾	4¾	4¾	5½
San Francisco	4¼	4½	4½	4½	4½	4½	5	5	5	5	5	5½

*Rate of 4¼ per cent on Government securities.

*Rate of 4¼ per cent on member banks' collateral notes, 4¾ per cent on customers' paper
 **Rates also apply to bankers' acceptances discounted by the New York and Cleveland banks
 †Rates on paper secured by War Finance Corporation bonds 1 per cent higher than on commercial banks
 Rate of 4½ per cent on member banks' collateral notes, 4¾ per cent on customers' paper
 Note 1 —Acceptances purchased in open market, minimum rate 4 per cent
 Note 2 —Whenever application is made by member banks for renewal of 15-day paper the federal reserve banks may charge a rate not exceeding that for 90-day paper of the same class

It could not be expected, however, that the changes in rates would bring about immediately a strengthening of the reserve position of the system as a whole. In the fall season of the year the demands upon the banks are always heavy and no material improvement could therefore be expected before the end of the year.

Changes in Reserve Percentages

Shortly prior to the announcement of the advance in rates, the reserve percentage of the federal reserve system had fallen to approximately 47 per cent as at the close of business on October 31. The report for the week ending November 8, showing condition at the close of business of the preceding day, indicated a reserve percentage of only about 46 per cent, while for the Federal Reserve Bank of New York the corresponding percentage was but little more than 40 per cent. During the week ending November 8, other federal reserve banks took over from the Federal Reserve Bank of New York ninety million dollars of acceptances, and in these circumstances in order to prevent further expansion, it became necessary to call the attention of the large rediscounting banks to the situation.

Practically the entire banking community recognized the necessity of curtailing the unduly large lines of loans which had been granted upon stock exchange collateral, and accordingly the developments during the week ending November 15 centered around the call-money market. The high call rate had the effect of checking further advances on purely speculative account and undoubtedly tended to promote liquidation. It was a precautionary measure on the part of the large rediscounting banks. The report of the federal reserve system for the week ending November 14 showed a reduction in discounts at the Federal Reserve Bank of New York, amounting to about eighty-four millions, a change which should have sufficed to improve the position of the system very materially, except

for the expansion of loans and discounts at other federal reserve banks, part of which was no doubt due to the crop-moving operations then in progress

The reserve percentages for the system as a whole since October 15 had been as follows

	Per Cent
October 17	48 3
October 24	48 7
October 31	47 9
November 7	46 8
November 14	47 1
November 21	46 9
November 28	45 5

Improvement between the dates November 7 and 14 was due to some extent to the transfer of a balance of German gold from the Continent to London, and the inclusion of the amount thus transferred in the banks' reserves

Banks and Speculation

The use by member banks of the resources of the system for speculative advances to their customers required the application of a corrective to the situation. It should be recalled that the resources of the federal reserve system were never intended for speculative purposes. Section 13 of the act provides in part that federal reserve banks may discount notes, drafts, and bills of exchange arising out of actual commercial transactions, that is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes. It provided further that nothing contained in the act shall be construed to prohibit such notes, drafts, and bills of exchange, secured by staple agricultural products, or other goods, wares, or merchandise, from being eligible for such discount, "but such definition shall not include notes, drafts, or bills covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or

other investment securities, except bonds and notes of the Government of the United States "

Clear and emphatic as the act thus was with reference to the speculative use of the resources of the system, experience had demonstrated that the prohibition of direct speculative loans did not of itself act to prevent the indirect use of funds obtained from the system for speculation. Bonds and notes of the government of the United States were not included in the list of prohibited collateral, and because so large a volume of these admissible securities was outstanding, the collateral loan was used to obtain accommodation and for making good reserves which might previously have been depleted by making ineligible loans. As Governor Harding, in a letter to Hon Robt L Owen, said "The Board has repeatedly called attention to the fact that resources obtained from the federal reserve banks should not be used for speculative purposes, and at various times when there has been unusual speculative activity it has issued public warnings as to the bad effect of such activities upon the banking situation. The first warning of this kind was issued as long ago as October, 1915, and the warning has been repeated on several occasions since that date when conditions made it necessary "

On June 10, 1919, the Board had already made public a letter, which it had addressed to all federal reserve agents, reading as follows

The Federal Reserve Board is concerned over the existing tendency toward excessive speculation, and while ordinarily this could be corrected by an advance in discount rates at the Federal Reserve Banks, it is not practicable to apply this check at this time because of Government financing. By far the larger part of the invested assets of Federal Reserve Banks consists of paper secured by Government obligations, and the Board is anxious to get some information on which it can form an estimate as to the extent of member bank borrowings on Government collateral made for purposes other than for carrying customers who have purchased Liberty Bonds on account, or other than for purely commercial purposes

This letter was sent out for the purpose of ascertaining to what extent government obligations were being used to secure loans from federal reserve banks for other than commercial purposes or for carrying subscriptions. The Board had called attention repeatedly to the dangerous speculative tendencies which have been prevalent.

Effect of Public Borrowing

The usual method of restricting the undue use of the rediscounting privilege is to advance rates. That policy would doubtless have been put into operation several months earlier except for its bearing upon government financing. The fact that the Treasury had sold more than twenty billions in bonds and Victory notes, many of which had been taken by persons who had been unable to pay for them in full but were obliged to carry them at banks, liquidating their obligations in part from time to time, and that member banks had obligated themselves to make loans to subscribers at coupon rates for a definite period of time, and that this policy on the part of the member banks had been approved by the federal reserve banks, materially altered the policy which would otherwise have been adopted by the Board. That a relatively low rate was maintained for the purpose of accommodating bona fide subscribers to government obligations opened an opportunity for other borrowers to obtain funds for their own purposes at comparatively low cost. This was availed of in large measure during the summer of 1919, and the speculative movement continued throughout the early autumn. These demands upon the banks for credit came in addition to the very heavy commercial requirements, to seasonal crop movement demands, and to needs arising out of unusual congestion of export commodities at ports. The advance in discount rates by federal reserve banks, announced early in November, was thus intended as a warning to the business community.

This situation, which reached its climax in November, did

not develop without warning. As Governor Harding has expressed it in the letter already referred to, "The high rates for call money which have prevailed continuously for the past two weeks and intermittently for several months past were in themselves very clear indication of the strained position into which the unbridled speculation had thrown the stock market and rendered a readjustment inevitable unless the resources of the Federal Reserve Banks were to be indirectly drawn upon for stock market purposes. The public has had ample notice of the Board's policy." The high rates for call money established early in the month of November exerted an important influence in discouraging undue applications for bank funds to be used in the carrying of securities. Call rates, in fact, practically throughout November maintained a high level, with a corresponding effect upon the volume of trading.

Location of Speculation

As pointed out in the Board's statement of November 4, 1919, the speculative situation was not regarded as being confined to any one part of the country, but there had been extraordinary speculative activity in all sections. The consequences of overspeculation are as evident and may be as serious when the funds of banks are used for the purpose of carrying commodities or real estate as they are when they are employed in a similar way in connection with stocks and securities. As was stated by the Board at the time, "The real character of the situation depends upon the use that is being made by member banks of credit facilities to be obtained at federal reserve banks. The reports which come to the Board from the federal reserve districts indicate a marked advance in the growth of speculative transactions", and again, "There has been an increasing demand for funds, speculation is attaining an unprecedented activity and is embracing real estate and many classes of commodities." It follows from what has been said, that the repression of undue speculative activity and

overextension of credit is as clearly a duty of the banking system in the South and West as it is in the East and North. In reply to a message received from a cotton-growers' committee, the Board on November 19 telegraphed the National Farmers' Union, in session at Memphis, that there had been no change in policy with respect to the extension of productive credit, but that federal reserve bank resources should not "be used directly or indirectly for speculative purposes nor for facilitating the hoarding of commodities for such purposes."

The Board had consistently advocated during the previous five years the policy of orderly marketing of crops. Assuming that adequate warehouse facilities were available, it seemed to be in the interest of the consumer as well as of the producer that staple commodities should remain as far as possible in the hands of producers until sold for consumption. This policy gave the producer the benefit of an average price, in that he was not required to "dump" his products upon the market in excessive volume, thereby depressing the price to the advantage of favored consumers or of speculators who do not as a rule pass the advantage on to the consumer. Owing to the great number of producers, there was always competition between them to sell, which would not be the case if large syndicates were able to acquire control of the bulk of the crop. But in times when there was a world-wide demand for necessities, there was no warrant for hoarding or withdrawing staple commodities from the market for speculative purposes, and the use of the resources of the federal reserve banks either directly or indirectly for speculative purposes was forbidden by the act.

Speculation in Commodities

Marketing, transportation, and sale of commodities are essential and legitimate industries, and as commercial operations have no speculative quality. They constitute a legitimate and normal basis upon which to ask for credit. Such operations tend to become speculative, however, when their time or

maturity is no longer limited to that period which is required for the transportation and orderly marketing of the staple commodities, or when credit is requested from the banks for the purpose of carrying commodities indefinitely in the expectation of an advance in prices. Whatever may be thought of such undertakings in periods when abnormally low prices have developed because of inability to market commodities in the normal way, due to sudden disturbances of the transportation system or other like conditions, as was true at the opening of the European war, there was no ground for withholding of such commodities from sale when a shortage of practically all staples prevailed throughout the world, and when the general level of prices everywhere was abnormally high. In such circumstances the use of bank credit for the purpose of carrying staples indefinitely in warehouses constituted an unwarranted drain upon the general fund of credit. These observations applied not only to cotton but to all other products which have a broad market.

Policy of Secretary Houston

In the effort to bring about a more normal state of things and to prevent the country from plunging further into a miasma of high prices and inflation, the policy of the Treasury was likely to be of the utmost importance. Secretary of Agriculture Houston had been appointed by the President as head of the Treasury upon the retirement of Secretary Glass, and almost immediately committed himself to the idea of retirement and of limitation of war credit. His policy in handling the finances of the Treasury was parallel to his policy of Treasury note refinancing, and as a corollary he early accepted the notion of ending the War Finance Corporation and terminating its activities. This determination on his part was announced early in 1920 and constituted an important step toward the elimination of unsound finance. At the same time the Federal Reserve Board continued to raise discount rates, the figures

advancing until about the middle of 1920, when they reached a maximum level of 7 per cent. It required no little courage on the part of the Treasury Department to see the prices of Liberty bonds fall off as the plan of cutting down the paper collateralized by such securities was pressed forward to completion, but the Secretary of the Treasury, having made up his mind to the necessity of the policy, adhered to it rigidly and steadily throughout.

Stock Market Recession

In the stock market the recession which had been initiated as a result of the first advance in discount rates, did not steadily continue but it was succeeded by fluctuations of value which were evidently the precursor of general reaction in quotations. The excessive price levels of the year 1919 had evidently passed their peak and there was a situation throughout the country which on the whole was inimical to further new financing at that time, both because of the exorbitant prices which had to be paid for materials of manufacture or for building, and because of the extremely high rates of interest at which new issues of securities could be successfully placed upon the market. Many who would have gladly refinanced themselves and converted their floating debt into funded obligations, shrank from the attempt because of their feeling that the level of interest charges and the general cost of refinancing had reached such a point as to make it a matter of great extravagance to accept these costs as permanent.

Warnings of Federal Reserve Board

In the discussion of the years following much was to be said with reference to the question whether the Board did or did not consciously start upon a policy of "deflation." There is little to indicate that any far-reaching or inclusive policy of deflation was developed by the Board at any given moment, but the Board frequently warned the public of the hazards

which it was facing in the then existing system of prices, the inflation of values, the excessive speculation, and was disposed to urge moderation in the further development of credit. Perhaps the best illustration of the Board's attitude with regard to this whole question may be found in the so-called Phelan bill, for which it was directly responsible and whose enactment it succeeded in obtaining from Congress. Believing as it did that some banks were getting by far too much credit and were using this credit in such a way as to harm or damage the banking situation in their respective communities, Governor Harding had conceived the idea that it would be desirable to introduce what was called a progressive rate of discount. The bill to that effect was drafted and placed in the hands of Representative Phelan, who meanwhile had become the chairman of the House Banking and Currency Committee. Mr. Phelan presented the measure with purely minor modifications, and it was adopted by both House and Senate early in 1920.⁸

The Phelan Act

As thus adopted, the Phelan Act provided for so-called progressive rates of discount, by establishing a basic line of credit beyond which further extensions of loans to banks should be made only at an increasing rate. The thought was that, after a member bank had obtained a certain amount of rediscount credit, the cost of further accommodation would become so heavy as to lead it to refrain from making further obligation, so that the reserve banks would not be subjected to the embarrassment of having to refuse accommodation on the ground that the member was already unduly extended and ought not to have more. For a long time there had been gradually developing in the system a feeling of reluctance with regard to applications for credit. Reserve banks were not disposed to say to their members that they must abstain from further applications, but they were inclined to urge that such banks

⁸ See Appendix A for legislative history.

should, whenever possible, discontinue lending upon eligible paper. Thus the reserve banks sought to restrict their advances either by limiting eligibility, or by in some way dissuading the public from other demands. While this may not have been a very courageous way of looking at the rediscount situation, it is worthy of special note at this point because it represents the point of view of the Board, which, although undoubtedly aware of danger and desirous of checking it, nevertheless yielded readily to demands for enlarged accommodation.

Errors of Phelan Act

The Phelan Act was thus the means of getting an artificial or automatic means of applying the brakes to a movement which should have been restrained by direct action, and its true character was revealed by the fact that, although in the beginning the Reserve Board had designed to make it mandatory, the recommendations of some of the reserve banks eventually resulted in making the progressive rate permissive, so that as it finally went into operation this permissive rate was applied only at four institutions—the reserve banks of Dallas, Atlanta, Kansas City, and St. Louis. It was essentially another serious and regrettable departure from the theory of the Federal Reserve Act. That theory had been based upon the idea of unlimited discount of all offerings of paper of the eligible varieties, with general advances in rates or narrowing of eligibility for the purpose of applying a check when necessary. The Phelan Act adopted the opposite point of view and shaped its policy upon the theory that the best form of check to an overrapid growth of credit was to be found in a cash penalty, afforded by the exacting of a progressive rate of discount from each customer. Later experience was to show in a definite way how unwise this plan certainly was, but it did not require experience to perceive the theoretic defects of the scheme, since they were inherent and grew out of a desire to find an easy way of refusing something whose withholding

could best and most wholesomely be accomplished by a blunt statement on the subject

Application of Progressive Rates⁴

Under the terms of the Phelan Act, provision was made for the application of graduated rates of rediscount, rising from a base rate to be established at the option of the board of directors of a federal reserve bank, according as the applications for rediscount filed by member banks exceeded a specified or base line to which the normal or basic discount rate was applicable. The new plan has been put into effect by four federal reserve banks. The basic line adopted by the Atlanta, St. Louis, and Kansas City banks was two and one-half times a sum equal to 65 per cent of the member bank's average reserve balance, plus its paid-in subscription to the capital stock of the federal reserve bank, both calculated over a fixed period to which the basic line applied. For the Dallas district, however, a basic discount line was adopted equal to the paid-in capital and surplus of the member bank. Atlanta and St. Louis applied the normal rate, i.e., the generally effective rate to all offerings for rediscount, and applied a progressive "super-rate" at the end of the reserve computation period to the average borrowings in excess of the basic line, while Kansas City and Dallas imposed the "super-rate" upon such part of the current offering as might, together with outstanding borrowings, be in excess of the basic line. As a scale of rates, all four banks adopted an increase of one-half of 1 per cent for anything up to 25 per cent in excess of the basic line, with 1 per cent for the second 25 per cent excess, and so on upward. Exceptions to this progressive rate plan were generally made in case of member-bank collateral notes secured by Government obligations, although some variation in method of making exceptions had been introduced in the four banks where the plan had been in effect.

As illustrative of the working of the plan, a concrete exam-

⁴ See Appendix B to this chapter

ple may be cited. A bank with a normal line of \$100,000 and borrowings of \$200,000 would be charged an excess or super-rate of one-half of 1 per cent on \$25,000, 1 per cent on an equal amount, 1½ per cent on a like amount, and 2 per cent on the final \$25,000. All paper under discount on the date the progressive rates became effective was exempted from the application of the super-rate, although counted as part of the general credit structure in determining the scale of super-rates applicable to new loans or to renewals. The working of the plan was of considerable interest because of the fact that it had not been applied in all districts, while there had been difference of opinion as to the theoretical advantages of it.

The following table from the Federal Reserve Bulletin affords a general view of the operation of this system for two representative months in 1920.

DISCOUNTED AND PURCHASED BILLS HELD BY GROUPS OF FEDERAL RESERVE BANKS

	Group 1		Group 2		Group 3		Total
	A	B	A	B	A	B	
May 28	1,752	1,686	424	510	762	742	2,938
June 4	1,794	1,732	420	499	760	743	2,974
June 11	1,769	1,706	415	488	742	732	2,926
June 18	1,603	1,564	405	456	686	674	2,694
June 25	1,708	1,682	415	468	707	680	2,830
July 2	1,793	1,785	421	475	721	675	2,935
July 9	1,777	1,782	421	462	736	690	2,934
July 16	1,729	1,705	413	484	705	658	2,847
July 23	1,709	1,685	414	501	700	637	2,823
July 30	1,708	1,677	413	515	716	645	2,837

NOTES. Group 1 shows totals for the Boston, New York, Chicago, and Minneapolis Federal Reserve Banks, all of which have raised their commercial discount rate to 7 per cent.

Group 2 shows totals for the Atlanta, St. Louis, Kansas City, and Dallas Federal Reserve Banks, all of which have adopted a system of progressive discount rates.

Group 3 shows totals for the remaining four banks, i. e., the Federal Reserve Banks of Philadelphia, Cleveland, Richmond, and San Francisco, which have neither raised their discount rates during the more recent period nor adopted a system of progressive discount rates.

Column A shows actual totals of discounted and purchased bills held.

Column B shows adjusted totals of discounted and purchased bills, i. e., exclusive of bills discounted for or bought from other Federal Reserve Banks, and including bills discounted for or bought from other Federal Reserve Banks.

Interdistrict Business

One phase of the discount situation which the Federal Reserve Board already perceived and perhaps thought to remedy by the application of the Phelan Act, was seen in the circumstances of some of the reserve districts which had become very much more inflated than others. It was also true that some of these districts were suffering the consequences of "frozen credit" at the close of the war and thereafter more extensively than were others. In fact, the war had not closed when the question of applying that provision of the Federal Reserve Act which permitted inter-reserve rediscounting had been brought into effect. The original act had never, as some have asserted, contemplated the idea that every district should be independent of every other, but on the contrary it had from the very beginning recognized the thought that many districts would from time to time have to call for assistance. The framers of the act, of course, had never imagined a condition similar to that which had existed at the close of the war, but they thought it quite likely the burden of "crop-moving demand" would be shifted to the reserve banks from time to time, with the result that the weaker reserve banks located in farming districts with a strong crop-moving demand would have to call upon the others for help. No such necessity had arisen prior to our entry into the war, practically all the reserve banks being, during 1914-1917, amply supplied with their own funds. A different situation had set in as the war advanced, and the Board had established the practice of ordering reserve banks which were high in funds to rediscount for others which were short of cash or which had only an insufficient percentage of reserve.

Opposition to Rediscounting

Strange to say, this rediscount policy, although it had originally been demanded and insisted upon by a good many

business men and bankers who, before they had seen the first draft of the Reserve Act, were inclined to charge that it did not take care of crop-moving needs, was now opposed by bankers. This opposition exhibited itself partly through the Federal Advisory Council. The reason for it was sufficiently plain and lay in the fact that business men and bankers in the more prosperous districts feared that their funds would be drawn off into districts where the resources available were insufficient or where the funds were likely to be used to take up and carry large frozen loans. There was also the usual element of selfishness in the situation. A good many commercial banks had done a profitable business in financing distant banks in the country regions, especially during crop-moving time. They undoubtedly feared that this element of their trade would be taken away from them, or its profitableness diminished, as the reserve system became able to finance completely the requirements of its members throughout the system. Chicago banks, for example, could endure the competition of the reserve bank in their own district, but they regretted to face the loss of profitable business in Missouri or Alabama, due to the fact that the southern reserve banks were permitted by the Board to draw off funds from the Federal Reserve Bank of Chicago and transfer them to those districts. This they felt was somewhat like using their own funds as a basis of competition with them, since they themselves, of course, had furnished the funds of the Federal Reserve Bank of Chicago. The opposition accordingly became intense, and perhaps could not well have been overcome had it not been for the existence and needs of the war.

Situation at the Close of War

The beginning thus made laid the basis for a large development of the inter-reserve bank discount policy at the close of the war. When the reaction in prices came on, under condi-

tions to be later reviewed, it became evident that the reserve banks in the South and West would not be able to meet the demands of their customers, or perhaps even to liquidate, without leaning heavily upon the stronger units of the system. Accordingly, an important element in the development of a discount policy was that of determining the relations between districts and the probable effect of low or high rates upon transfers of funds through the reserve banking system. In a general way, the necessity of transferring funds between districts ought to have operated toward the material raising of the rates in the lending districts, with an even greater advance in the southern and western borrowing sections. When the time came for the advance of rates, as it did at the close of 1919, the Federal Reserve Board, therefore, deemed it best to assure the banks that, no matter what might be done, rates would be kept so adjusted that they could rely upon getting accommodation from other members of the system. In fact, it is undoubtedly true that the Reserve Board never refused an application for inter-reserve rediscount made by a reserve bank.

In such circumstances a very marked increase of this kind of business was to be expected, and it in fact moved upward toward a peak which it reached in 1921. After that year, business recession and gradual liquidation enabled the weaker reserve banks to cancel their indebtedness, and the year 1922 saw the reserve banks entirely free of such business. Certain important aspects of this phase of the discount situation have been analyzed by the author in the Federal Reserve Bulletin⁴ as follows:

INTERDISTRICT MOVEMENT

The amount of interdistrict shifting of credit can be seen from the following compilation, which gives the figures for each of the first seven months of 1921:

⁴ For September, 1921.

1348 FEDERAL RESERVE SYSTEM IN OPERATION

REDISCOUNTS AND SALES OF DISCOUNTED AND PURCHASED PAPER BETWEEN
FEDERAL RESERVE BANKS
(In thousands of dollars)

	Dis- counted bills	Pur- chased bills	Total
1921			
January	\$ 98,458	\$ 51,138	\$149,596
February	39,500	7,848	47,348
March	33,000		33,000
April	47,000		47,000
May	77,000		77,000
June	111,000		111,000
July	123,507		123,507

During the present year the interdistrict movement of funds has been less complex in character than during the preceding year. The influence of war conditions has become more remote, while the peak of the readjustment period, with its manifold reflections in the position of the banking system, has been passed. The banking situation has

REDISCOUNTS AND SALES OF PAPER BETWEEN FEDERAL RESERVE BANKS,
FIRST SEVEN MONTHS OF 1921
(In thousands of dollars)

Federal Reserve Bank of—	Amount received		Amount furnished	
	Redis- counted	Sold	Dis- counted	Pur- chased
Boston			\$ 84,550	\$10,671
New York		\$57,646	267,500	340
Philadelphia			5,000	6,823
Cleveland			172,415	25,094
Richmond	\$220,000			
Atlanta	27,957			
Chicago		1,315		
St. Louis				1,000
Minneapolis	69,000			
Kansas City	9,008			
Dallas	203,500			
San Francisco		25		15,058
Total	\$529,465	\$58,986	\$529,465	\$58,986

become easier, and conditions during the present year more nearly reflect what may be considered to be the normal interdistrict movement of funds. As would be expected, the volume of the movement is considerably less than a year ago. A smaller number of districts also have required aid. The movement this year has been more distinctly seasonal in character. While a number of the agricultural districts have been self-sufficient and self-dependent in a financial way, those which have received accommodation from others have been primarily agricultural districts. At the same time, the distinctly industrial districts have been those which have supplied the funds required.

The preceding table shows the amount furnished and the amount received by each district in rediscounting with others during the first seven months of the year 1921.

DISTRIBUTION OF CREDIT

While the Federal Reserve System is in a strong position to meet requirements, and while the machinery for distributing credit to the different sections of the country is even more perfect than heretofore, there have been some complaints of defects in the distribution of it. Whatever these defects may have been, they have not been due to any lessening in the number of banks accommodated during the season, as may be seen from the following table, which shows comparatively the total number of institutions accommodated during the past few years. From this it appears that the aggregate number of banks receiving rediscount credit is now greater than at any time in the past.

NUMBER OF BANKS ACCOMMODATED THROUGH THE DISCOUNT OF PAPER
DURING SPECIFIED MONTHS, 1917-1921

Month	1917	1918	1919	1920	1921
March	315	1,568	4,758	3,670	5,332
June	900	3,021	4,047	4,948	5,740
September	953	3,464	3,722	4,758	-
December	1,701	3,288	3,659	5,551	-

As has been pointed out, however, in recent discussion, this distribution of credit can be considerably furthered by a more general utilization on the part of the banks. The loans made by the member and nonmember banks throughout the country are not in all cases well distributed, and in a number of cases have not been judiciously made. Something over a third of all member banks have at times appeared

not to be borrowing from the Federal Reserve Banks at all, and of the two-thirds which were borrowing, more than one-half were borrowing very large amounts. Many of these banks extended themselves so far that they do not now feel warranted in making any new loans, regardless of the disposition of the Federal Reserve Banks to rediscount the paper. They do not want their names on any more paper than they already have indorsed. They are indisposed to increase their contingent liability. No doubt this situation will be corrected as the season advances, through a broader participation on the part of the banks in rediscounting, which is clearly evident in the statistics already cited.

CHANGES IN DISCOUNT RATES

The changes in discount rates on agricultural paper which have become effective during the past two months have resulted in a rate schedule which compares with that in effect a year ago, as follows:

FEDERAL RESERVE BANK DISCOUNT RATES ON AGRICULTURAL PAPER
MATURING WITHIN SIX MONTHS, IN EFFECT SEPT. 1, 1920 AND 1921

Federal Reserve Bank	1920	1921
Boston	7	5½
New York	7	5½
Philadelphia	6	5½
Cleveland	6	5½
Richmond	6	6
Atlanta	6	6
Chicago	7	6
St. Louis	6	6
Minneapolis	7	6½
Kansas City	6	6
Dallas	6	6
San Francisco	6	5½

From these figures it will be seen that a reduction in discount rates applicable to agricultural paper varying from one-half to 1½ per cent has taken place at many banks during the past year, while at others the rate was never above 6 per cent.

Some Conclusions

Summing up what has been said, it may clearly be inferred that the federal reserve system had not fully resumed control of discount rates. Before the time had come when the Board

could effectively raise its rates, reaction which would naturally have set in under any circumstances was about due. The Board's advance of rates may have "given the signal" for such reaction, but did not do much more than that. It may have accelerated or accentuated a movement which would otherwise have developed, but certainly did not restrict the expansion in lines of credit or materially tend to prevent business from moving into speculative channels. Least of all, was there any evidence of a definite deflation policy applied in an effective way through refusal to discount paper based upon stored commodities or whose proceeds were to be used in stock or other speculation. The resumption of the control of discount rates, of which much has been said, must therefore be regarded as having been theoretical, due to the fact that the raising of rates was invariably deferred until such time as the movement of prices had far outgrown such control.

APPENDIX A TO CHAPTER LIX

Some misunderstanding has occasionally arisen from references to the "Phelan bill." Two measures are usually referred to under that title, the one adopted in 1918, the other in 1920. The text above deals with the law of 1920, but a brief outline of the earlier measure of 1918 is herewith given.

LEGISLATIVE HISTORY OF THE PHELAN BILL OF 1918

House Bill 11283 was introduced on April 8, 1918, by Mr. Phelan and considered on the 24th. In his explanation Mr. Phelan brought out the following main points of the amendment. The first section provided for a slight change in the method of election of class A and class B directors. Under the original act member banks were grouped according to their capitalization, in three groups each of which was to include possibly an equal number of banks. It had however been found impossible to put into one group a number of large banks equal to the number of medium or small sized banks in the second group for the reason that there were fewer large banks. As a result it was practically impossible to do what was actually intended. The new provision left it to the discretion of the Federal Reserve

Board to decide the number of banks which were to go into one group, while the provision that the banks in each group should be as nearly as possible of the same capitalization remained

Mr Phelan said "We feel that the smaller banks ought to have representatives who will represent them for their interest, and not for other interests interfering with that representation" (Record, p 5575, 65th Congress, 2d Session)

Section 2 referring to section 11 (k) of the Federal Reserve Act extended the fiduciary powers which were already granted to the national banks so as to par them altogether with the State banks, to the effect, " that the Federal Reserve Board shall have the power under the limitations of the act, to grant these fiduciary powers to national banks even though in the State law there is expressly or by implication some prohibition to the granting of this power to national banks, with, however, this provision That that shall apply only where as similar power is granted to State banks, trust companies or other competing corporations " (P 5576) As Mr Phelan explained, the provision was intended to prevent national banks from being discriminated against by the States

Another provision of the bill called for the issue of federal reserve notes of larger denominations including \$500, \$1,000, \$5,000, \$10,000 notes, with the purpose of conserving the gold supply "At the present time certain individuals, corporations and banks in particular, like notes of large denomination, which makes it easier for exchange purposes to pay off balances and other purposes" (P 5578) Since federal reserve notes would serve as well as gold certificates, which were used until then, the constant draft on the gold supply would be avoided

Section 4 amended the act in reference to reserve requirements It permitted the Federal Reserve Board to let down the reserve requirement in certain instances "It permits the Federal Reserve Board in the case of banks situated in outlying districts of central reserve cities, which are New York, Chicago and St Louis, and in territory which has been incorporated within the municipal limits of those cities through expansion, to require of banks in such sections only such reserves as are required of banks in reserve cities or only such reserves as are required of country banks as the board may decide." (P 5579) A similar provision was included with reference to banks in reserve cities

Section 5 of the bill was intended to clarify section 22 of the act, which had remained all the time doubtful as to its interpretation "There was nobody who could tell authoritatively as to what or what

could not be done, because no attorney connected with the Federal Reserve Board or Treasury Department or anyone connected with the Department of Justice could tell what a court would hold nor was any such individual authorized to give a definite construction of the section" (P 5580) Subsections (a) and (b) were simply a re-enactment of the existing law Subsection (c) prohibited any director from getting any commission for any service rendered by him, like obtaining a loan, getting a note, etc In subsection (e) it was provided that no officer of the bank could obtain any higher rate of interest on his deposits than anyone outside the bank Subsection (d) modified the provision forbidding directors of a bank to sell securities to the bank, since the enactment of this prohibition had resulted in driving men who were in the security business off the boards of directors Mr Phelan admitted that from a theoretical banking standpoint it was not desirable to have such men on the boards But owing to the peculiar development of the banking business in this country the practical situation had to be met "Hence the committee felt we ought to go at this thing in a liberal spirit, provided we safeguarded things, so that it is difficult if not impossible for an abuse to grow out of what we frame, that we ought so far as possible to liberalize the provision relative to the board of directors of these various banks" (P 5580)

The next two sections, while long and complicated, were simple, as Mr Phelan explained, when it was understood what they intended "They simply apply the existing law with reference to national banks, to Federal reserve banks In other words, strange as it may seem there is no statute law punishing officers or employees of the Federal reserve banks for overcertification of checks and other offenses"

Practically the only objection was raised by Mr Robbins, who protested against the extension of fiduciary powers The real purpose of this provision he asserted was, to force the trust companies into the federal reserve system "That is what you intend to do, and it will affect more or less the special privileges and franchises that these companies hold and enjoy, under which they have been doing business in many instances for more than half a century, some of them, and will affect the right that they have already acquired and have long enjoyed under the laws of our State" (P 5586)

The bill was passed by a large majority

Mr Owen reported an amendment, striking out all except section 3, providing for the printing of large denominations of reserve notes, and section 7, imposing penalties for embezzlement of the funds of federal

reserve banks. The bill as amended passed the Senate with little discussion, and a conference was agreed to on the part of both houses.

On September 9 Mr Owen reported in the Senate a disagreement on the bill. Since the House conferees insisted on the adoption of the provision as to fiduciary powers, and the Senate had previously voted for the bill without this section, Mr Owen did not feel justified in agreeing to that proposal, until the Senate had been informed of it. "Personally I think that the trust privilege ought to be granted, because in some instances the national banks are subject to a serious handicap because of the competition of State banks, and I think it desirable, that the banks should be upon the same basis, so that, when they do compete with each other they may compete upon fair terms" (P 10097). No further debate ensued and when the conference report was presented on September 18, the Senate receded from its amendments, and the report was adopted. The House likewise voted upon it favorably on the same day.

APPENDIX B TO CHAPTER LIX

WORKING OF THE PHELAN ACT OF 1920⁵

In January, 1923, Acting Governor Platt sent to the Senate a full account of operations under the Phelan Act, as follows:

Washington, January 17, 1923

Sir: On December 7, 1922, the Federal Reserve Board received from the Secretary of the Senate a resolution (S Res 335) adopted December 6, 1922, reading as follows:

"Resolved, That the Federal Reserve Board be requested to obtain from the federal reserve banks of Atlanta, St. Louis, Dallas, and Kansas City statements showing all cases where interest ranging between 10 per cent and 87½ per cent per annum, both inclusive, was exacted from member banks, giving names of the banks, their capital and surplus, and location where 10 per cent per annum or more was charged on loans and rediscounts, the rate and amount of interest charged in each instance as expressed in dollars and cents, also a statement showing whether the federal reserve banks have refunded to each member bank from which such exactions were made the amount of such interest collected in excess of 10 per cent per annum upon each loan upon which such interest was charged."

In view of the fact that progressive rates were assessed against average borrowing in excess of the basic line determined in the manner outlined in Appendix A [not given in this book], attached to this reply by the Federal Reserve Banks of Atlanta, St. Louis, and Dallas, and not against each individual loan, and that the same result was obtained

⁵ Congressional Record, 67th Congress, 4th Session, p. 2565

by the Kansas City Federal Reserve Bank by adjustments and rebates currently made, it would have been possible to have interpreted the resolution as applying only to those banks which were charged interest at the rate of 10 per cent or more on total borrowings during any period in which progressive rates were assessed. If this had been done, the report of the Board would have covered only 5 banks in the Atlanta district, 5 in the St. Louis district, none in the Dallas district, and 16 in the Kansas City district. The Board felt that such interpretation would not give the Senate the information desired, nor would it give a fair picture of the real effect which the progressive rates had on borrowings of member banks. Accordingly, the resolution was interpreted to call for the additional discount charged member banks at progressive rates in each instance where the maximum point to which the rate progressed was 10 per cent or over. The report therefore covers 44 banks in the Atlanta district, 49 in the St. Louis district, 114 in the Kansas City district, and 20 in the Dallas district.

It should be understood, however, that the range of rates charged is merely a record of the mathematical steps used in the calculation of the amount of discount chargeable under the progressive-rate plan. It was somewhat similar to an interest table, in that tables could have been used showing the average rate to be charged under each range of progressive rates. As stated in Appendix A to this letter, graduated rates were progressed at the rate of one-half of 1 per cent for each 25 per cent by which the amount of borrowings exceeded the basic line. In the calculation of the amount of discount chargeable, therefore, it was necessary to divide the excess borrowings into portions equivalent to 25 per cent of the basic discount line of the member bank and then to assess the superrates by successive steps, beginning with one-half of 1 per cent.

For example, if a certain member bank had a basic discount line of \$100,000 and its total borrowings during a given month averaged \$400,000, of which \$100,000 was secured by Government obligations and exempt from the application of progressive rates, its excess borrowings subject to progressive rates would amount to \$200,000, as indicated below:

Total borrowings, average during the month			\$400,000
Deduct			
Basic discount line		\$100,000	
Paper secured by Government obligations and exempt from the application of progressive rates		100,000	
		<hr/>	<hr/>
			200,000
Excess borrowings subject to progressive rates.	....	..	\$200,000

Progressive rates increasing at the rate of one-half of 1 per cent for each \$25,000—25 per cent of basic line—by which the borrowings subject to progressive rates exceeded the basic line would have been assessed against the \$200 000 as follows

\$25,000 for one month at one-half per cent	\$ 10 42
\$25,000 for one month at 1 per cent	20 83
\$25,000 for one month at $1\frac{1}{2}$ per cent	31 25
\$25,000 for one month at 2 per cent	41 67
\$25,000 for one month at $2\frac{1}{2}$ per cent	52 08
\$25,000 for one month at 3 per cent	62 50
\$25,000 for one month at $3\frac{1}{2}$ per cent	72 92
\$25,000 for one month at 4 per cent	83 33
Total (\$200,000)	<hr/> \$375 00

In this particular case the member bank would have been charged \$375 on its excess borrowings of \$200,000 for one month—in addition to the discount charged at the basic rate—and this would represent an interest charge of $2\frac{1}{4}$ per cent on the excess borrowings of \$200,000, or of $1\frac{1}{8}$ per cent on total borrowings. As explained below, this would have represented an interest charge on total borrowings of $6\frac{7}{8}$ per cent.

It will readily be seen from the above example that the rate which is most significant, inasmuch as it measures the extent of the penalty imposed on the member bank under the progressive-rate plan, is the one which, when applied to the total amount of excess borrowings, yields the amount of interest charged to the member bank. In the case just described this rate is $2\frac{1}{4}$ per cent and not 4 per cent. The total rate chargeable on excess borrowings in the above example would be 8 per cent, or the basic rate, which may be assumed to be $5\frac{3}{4}$ per cent, plus the average superrate of $2\frac{1}{4}$ per cent on excess borrowings. This calculation should be carried one step further in order to determine the average rate such a bank would be paying on its total borrowings at the Reserve Bank, which we find to be $5\frac{3}{4}$ per cent plus $1\frac{1}{8}$ per cent, or $6\frac{7}{8}$ per cent, at a time when the bank was borrowing altogether an amount equal to four times its basic line.

It may be well at this point to call attention to the fact that while there has been considerable criticism of the progressive rates as applied by the four Federal Reserve Banks, most of the criticism has come from sources other than the banks which paid these progressive rates. In fact, as shown on pages 47–48 of part 22 of hearings before the Joint Commission of Agricultural Inquiry, the Kansas City Federal Reserve Bank received resolutions from banks in a number of cities in its district requesting that the progressive rates be continued.

A careful examination of the statements inclosed herewith will show

that very few of the banks paid an average rate—normal rate plus superrate—on total borrowings as high as 10 per cent in any period during which progressive rates were assessed, even before rebates were made of interest charged in excess of 12 per cent by the Atlanta and Kansas City Federal Reserve Banks. In the case of the Dallas Reserve Bank the maximum average rate charged on total borrowings did not reach 8 per cent except in the case of one bank, and in that instance it only reached $8\frac{1}{2}$ per cent. When it is taken into consideration that the average rate charged by member banks to customers in this district, especially in the smaller towns, was from 8 to 10 per cent, it will be readily seen that the adoption of the progressive rates, though it may have reduced materially the profits of the borrowing member banks, did not penalize them in the sense of making them pay more for accommodation at the Federal Reserve Bank than they were charging their customers. Even in the much-quoted case of the bank in the Atlanta district which paid a maximum rate of $8\frac{1}{2}$ per cent on a small portion of its excess borrowings during the two-week period ending September 30, 1920, we find that that bank was charged only 13.37 per cent on total borrowings during the period from June to November when it was assessed progressive rates and only 8.8 per cent after charges in excess of 12 per cent were rebated.

One reason for the high progressive rates in the Kansas City district was that as they were applied to current borrowings at the time paper was offered for discount, and the rate of progression began at a point determined by the amount of the bank's borrowings in excess of the basic line, including the current offerings, the minimum rate applicable was frequently materially above the basic rate. These rates were charged, however, with the distinct understanding that the excess in the amount of interest charged over what would have been charged had progressive rates been applied to daily excess borrowings instead of to the current offerings would be subsequently rebated.

The resolution requests the Federal Reserve Board to give the Senate the name, capital and surplus, and the location of each bank which paid interest at progressive rates ranging from 10 to $8\frac{1}{2}$ per cent per annum, together with the rates paid and amount of interest charged in each case. While the Board desires to comply with the resolution in its entirety, it does not feel at liberty to divulge the names of member banks which were charged interest at progressive rates. Many of the member banks in these four districts, which were borrowing excessive amounts from the Federal Reserve Banks and consequently paying progressive rates, were in a very overextended condition, and if the

name of any particular bank were made public in this connection it might create doubt in the minds of some of the bank's customers as to its soundness and as to the judgment and ability of those responsible for its management. Some of the bank's depositors might withdraw their accounts in the belief that it is not safe to leave their funds on deposit with an institution which had been permitted to get into an extremely overextended and perhaps unsafe condition. In the statements submitted herewith the names and locations of individual member banks have, therefore, been omitted.

In adopting the policy of charging progressive rates, the Federal Reserve Banks were guided by the fundamental principle that each member bank is entitled to accommodation in proportion to its contribution to the lending power of the Federal Reserve Banks, consisting of its lawful reserve on deposit with the Federal Reserve Bank and its quota of the paid-in capital stock. It was this contribution to the Federal Reserve Bank's lending power which was used in determining the normal or basic discount line, except in the case of the Federal Reserve Bank of Dallas, where the capital and surplus of the borrowing member banks was used as the basic line. This was done for the reason that the directors of the Dallas bank, after careful analysis, felt that this method of determining the basic line was more satisfactory, especially in the case of the smaller banks. The principle of the basic line is recognized in section 4 of the Federal Reserve Act, which provides that the board of directors of each Federal Reserve Bank shall, "subject to the provisions of law and the orders of the Federal Reserve Board, extend to each member bank such discounts, advancements, and accommodations as may be safely and reasonably made with due regard for the claims and demands of other member banks." The authority for charging progressive rates is contained in section 14 of the act, which provides that discount rates, "subject to the approval, review, and determination of the Federal Reserve Board, may be graduated or progressed on the basis of the amount of the advances and discount accommodations extended by the Federal Reserve Bank to the borrowing bank." The method of arriving at the basic discount line in each of the four districts was determined by the boards of directors and is fully explained in Appendix A [not shown].

While the details of operation of the progressive rate scheme were somewhat different in each of the four Federal reserve districts in which it was put into effect, the Board has endeavored to present the figures for all four districts in as uniform a manner as practicable, in order that the data may be as nearly on a comparable basis as the

different methods of application will permit. But it has been necessary to use three slightly different forms of presentation, one for the Federal Reserve Districts of St. Louis and Dallas, another for the Kansas City district, and a third for the Atlanta district. In examining these statements, it should be borne in mind that the object has been to show the additional discount charged at rates above normal, i.e., the penalty which was assessed against each member bank on account of its obtaining accommodation in an amount greatly in excess of its equitable proportion of the lending power of the Federal Reserve Bank.

Amounts shown in the columns, "Additional discount charged at superrates," therefore, do not include—and this is explained in the note at the bottom of each statement—the discount charged at normal or basic rates which the bank would have been required to pay had no progressive rates been in effect. Likewise, the rates shown in the tables are stated exclusive of the normal discount rate in order to enable one to get a clear picture of the penalty rate assessed. If it is desired to obtain the average rate applied to borrowings in excess of the basic line, or to total borrowings, it will be necessary to add the normal-rate in effect to the superrates shown. For instance, member bank No. 1 in the Kansas City statement was charged in May, 1920, a superrate on excess borrowings, before adjustments and rebates, of 2.46 per cent, and on total borrowings of 1.12 per cent. These rates, when added to the normal rate of 6 per cent—applicable to all paper not secured by United States Government obligations—bring the total rates charged up to 8.46 and 7.12 per cent, respectively. The rates shown in the column headed, "Range of superrates," are also the penalty rates charged, and must therefore be combined with the normal rate to get the total rate charged. Therefore, in cases where the penalty or superrates ranged from one-half to 4 per cent, the total rate charged on borrowings in excess of the basic line ranged from 6½ to 10 per cent.

The normal rate in the four districts which applied progressive rates was 6 per cent on all paper except that secured by United States Government obligations. Such paper was accorded preferential rates, with a minimum of 5 per cent, during the period in which progressive rates were in effect. In the Atlanta and Dallas Federal Reserve Districts rates on paper secured by Liberty Bonds and Victory Notes remained at 5½ per cent during the entire period in which progressive rates were in effect. In the St. Louis and Kansas City districts the rates were increased from 5½ per cent to 6 per cent on May 21, 1921,

and September 28, 1920, respectively. When progressive rates were established, rates on paper secured by Treasury Certificates of Indebtedness were 5 to 5½ per cent in each of the districts except Kansas City, where a uniform rate of 5 per cent was in force. While the minimum rate remained unchanged in the Atlanta and Dallas districts, the maximum rate was increased to 6 per cent on July 2, 1920, by Atlanta, and on July 13, 1920, by Dallas. The discount rate actually chargeable on such paper corresponded with the rate borne by the securities pledged as collateral within the minimum and maximum limits stated above. In the case of the St. Louis district on January 22, 1921, a flat rate of 6 per cent was substituted. The Kansas City Federal Reserve Bank increased its maximum to 6 per cent on July 3, 1920, and on July 1, 1921, adopted a uniform 6 per cent rate on all classes of paper.

In view of these preferential rates on paper secured by Government obligations, the average normal or basic rate charged in these districts was somewhat below the 6 per cent rate on commercial and agricultural paper in effect and averaged around 5¾ per cent.

The Kansas City Federal Reserve Bank applied the progressive rates to paper at the time it was offered for discount, and in accordance with its previously announced policy made current daily adjustments in the amount of discount charged on excess borrowings as paper matured and was paid. The borrowing member bank knew, therefore, that the progressive rates originally applied were only tentative and that after adjustments and rebates they would be charged progressive rates only on their actual borrowings in excess of their basic line. This plan of operation, however, made it necessary, in order to present a complete picture, to show in the exhibit for the Kansas City bank the amounts charged member banks at superrates, both before and after adjustments and rebates. In both the Kansas City and Atlanta districts, rates of interest charged certain member banks progressed to exceptionally high levels, largely because of the fact that these member banks allowed their reserve balances—which entered into the determination of the basic line—to fall far below legal requirements. In view of the high rates, these two Federal Reserve Banks requested and obtained permission from the Federal Reserve Board to rebate all discounts charged in excess of 12 per cent. In the case of the Atlanta Federal Reserve Bank, the amount of discount charged at superrates, both before and after these rebates, is shown, while in the case of the Kansas City bank these rebates have

been included with the rebates arising from current adjustments explained above

As brought out in Governor Harding's testimony before the Joint Commission of Agricultural Inquiry, and in the report of that commission, the situation in some of the Federal Reserve Districts early in 1920 was such that a relatively small number of banks were borrowing excessively from the Federal reserve banks, while other member banks were borrowing little or nothing. At that time the reserve percentage of the Federal reserve banks was approaching the legal minimum provided in the Federal reserve act, and it was therefore felt that, if member banks which were not borrowing should apply for such advancements and accommodations from the Federal reserve banks as they were entitled to receive, the Federal reserve banks would soon find themselves in a position where the reserve requirements provided in the Federal reserve act would have to be suspended. The Federal Reserve Board and the Federal reserve banks concerned felt that there should be a more even distribution of accommodation extended to member banks, and four Federal reserve banks—Atlanta, St. Louis, Kansas City, and Dallas—requested and obtained approval of the Federal Reserve Board to establish progressive rates which would have the effect of restraining borrowings on the part of banks in an overextended condition. It was thought that this would discourage such member banks from making further loans and that consequently any demands for additional credit would come largely from banks which were not in an overextended condition.

As a matter of fact, this is about what happened, as may be seen from the following quotation taken from pages 56-58 of part 2 of the Report of the Joint Commission of Agricultural Inquiry, which relates to loans in the Kansas City district:

"In January, 1920, 14 banks in Kansas City had absorbed 34 per cent of the normal lending power of the federal reserve bank and 9 Omaha banks had absorbed 23.5 per cent. Therefore these two cities alone had absorbed 57 per cent of the normal lending power of the Kansas City Federal Reserve Bank. There was a slight recession in the borrowings of these banks due to temporary seasonal deflation in the early part of 1920, but by April, 1920, the 14 Kansas City banks were absorbing 50 per cent of the normal lending power of the Kansas City Federal Reserve Bank and 9 Omaha banks were absorbing 23 per cent, representing a total of 73 per cent of the normal lending power of the Kansas City Federal Reserve Bank, and leaving only 27 per cent of the normal lending power available for the 1,063 other member banks in the Kansas City district.

"In the period from April 19, 1920, to December 31, 1920, banks which had not been previously borrowing increased their

borrowings to 12 per cent of the normal lending power of the Kansas City Federal Reserve Bank. During the same period the number of banks borrowing in the Kansas City Federal Reserve District increased from 178, or 16.8 per cent of all the banks, to 416, or 38.3 per cent of all the banks. In the same period the amount borrowed by all borrowing banks increased from \$106,851,047 to \$117,328,475. While banks not borrowing previously to April 19, 1920, when the progressive rate became effective, were increasing their borrowings, the borrowings of the 14 Kansas City member banks paying the progressive rate decreased to 36 per cent of the normal lending power of the Kansas City Federal Reserve Bank, and the borrowings of the 9 Omaha member banks paying the progressive rate decreased to 13 per cent of the normal lending power of the Kansas City Federal Reserve Bank.

"One effect of the adoption of the progressive rate in the Kansas City Federal Reserve District, therefore, apparently was to compel a reduction in the proportion of the lending power of the Kansas City Federal Reserve Bank, which was being absorbed by the large city banks in Kansas City and Omaha, and to permit the use of that lending power in meeting the requirements of banks which were previously not borrowing or borrowing only moderately."

In examining borrowings of member banks in the larger cities, such as New York, Chicago, and Boston, we find that no member bank in any one of these cities at any time borrowed from the Federal Reserve Banks an amount in excess of two and one-half times its basic line. Consequently, had the progressive rates been in effect in these districts without exemption of paper secured by United States Government obligations, no member bank, with one exception, in any of these cities would have at any time paid an average rate on total borrowings as high as 7 per cent, and in the case of this one exception the average rate would have been less than 7.05 per cent. In this case, however, the bank's entire borrowings were secured by obligations of the United States Government.

It is clear, therefore, that every member bank in these big cities, borrowing at the 7 per cent commercial paper rate, whether or not borrowing in excess of its basic line, paid a higher rate of discount than it would have been required to pay had the Federal Reserve Banks in those cities adopted a 6 per cent rate on commercial loans with progressive rates such as were in effect in the Atlanta, Kansas City, St. Louis, and Dallas districts. This statement is based upon the assumption that no loans to these banks in excess of their basic lines would have been excepted from the application of progressive rates, as a matter of fact, as is shown in Appendix A, most of the paper secured by obligations of the United States Government was

exempted from the application of progressive rates in all districts. In the case of the Atlanta district, paper drawn for strictly agricultural production up to 100 per cent of the bank's capital and surplus was also excepted from the application of progressive rates.

From an examination of the statements inclosed herewith, it will be noted that the average superrate—excess over normal rate—if applied to total borrowings, very rarely exceeded a reasonable penalty charge, even in the case of those banks which were in a highly over-extended condition. In the case of the bank in the Atlanta district which was charged superrates reaching in one instance as high as $8\frac{1}{2}$ per cent, it appears that during that particular two-week period the average superrate applied to total borrowings was 27.44 per cent before the Federal Reserve Bank rebated all discount charged in excess of 12 per cent, and 3.88 per cent after such rebate was made.

With regard to this bank, the following is quoted from a letter received from the chairman of the board of directors of the Federal Reserve Bank of Atlanta, printed on page 318 of part 13 of the hearings before the Joint Commission of Agricultural Inquiry:

"Taking the matter as a whole, however, from the statement submitted below, it can be seen that while the progressive rates seem exorbitant the average rates paid to us for money borrowed during this period, when applied against the average borrowings, will not show anything in comparison to the seemingly high progressive rates shown. For instance, the average borrowings of the ——— National Bank for the period from June 15, 1920, to October 15, 1920, was \$149,830. The normal discount rate at 6 per cent on this amount would be \$2,996.60. Add to this amount progressive discount rates charged, \$3,680.15, and this less progressive discount rates rebated \$2,281.56, would leave net amount of interest paid \$4,395.19, which would result in a rate charged for the average borrowing of 8.80032 per cent per annum."

At the time the high progressive rate was charged this bank it was borrowing from the Federal Reserve Bank an amount equal to almost seven times its own capital stock, and at the same time had allowed its reserve balance to fall so much below legal requirements—from \$9,433 to \$86—that its basic discount line, which is based upon the amount of its contribution in the form of capital stock subscription and reserve balance, was less than one-sixth of what it would have been had its reserves been maintained in accordance with the Federal reserve act. This failure to maintain reserves as required by law resulted in the bank's having a very low basic line and consequently the ratio of its borrowing to its basic line rose very rapidly. Had

the bank maintained the reserve required by law, the maximum rate charged would have been 17 per cent, and the average rate on total borrowings, even before rebates were made, would have been 9.19 per cent during this semi-monthly period.

At the time the Federal Reserve Board authorized the Federal Reserve Banks to establish progressive rates, it was not expected that any member bank would permit its lawful reserve balance to decline almost to the vanishing point, especially at a time when it was in so badly overextended a condition as to necessitate borrowings from the Federal Reserve Bank in an amount equal to several times its own capital and surplus. The Federal Reserve Board did not approve of excessive rates, and as soon as it became apparent that the progressive-rate plan in effect was in some instances resulting in unreasonable rates immediate consideration was given, both by the Board and the Federal Reserve Bank, to devising some plan whereby such results could be obviated. As a matter of fact, the high rate of 87½ per cent was charged in the two-week period ending September 30, 1920, and reports of these transactions were received by the Board some time during October, and on November 1 the progressive rates in the Atlanta district were abolished and that bank substituted in lieu thereof a flat commercial rate of 7 per cent, which was in effect also at the Federal Reserve Banks of Boston, New York, Chicago, and Minneapolis.

It is a noteworthy fact that the excessively high rates charged in the Atlanta and Kansas City districts in certain instances were, as in the case discussed above, due primarily to the effect upon the member bank's basic discount line of its failure to maintain its legally required reserve balances with the Federal Reserve Bank. In the case of St. Louis and Dallas, the member bank's basic-discount line, in consequence of the method by which it was determined, was in nowise affected by failure to maintain its reserves, and accordingly in these two districts the rates charged did not reach excessive levels and no rebates were made, as was done in the Atlanta and Kansas City districts, where all interest charged in excess of 12 per cent per annum was subsequently rebated. These rebates amounted to \$9,108.66 in the Atlanta district and to less than \$300 in the Kansas City district.

As an illustration of the relationship between discount rates charged by the four Federal Reserve Banks which adopted the progressive rate plan and the rates charged by the other banks, there are shown below the average rates—including discount at progressive rates—charged by each Federal Reserve Bank during 1920 and 1921.

Federal reserve bank	1920	1921
Boston	6 03	5 88
New York	5 97	6 06
Philadelphia	5 44	5 44
Cleveland	5 66	5 72
Richmond	5 78	5 91
Atlanta	5 97	6 05
Chicago	6 32	6 29
St Louis	5 98	5 90
Minneapolis	6 40	6 35
Kansas City	6 65	6 14
Dallas	5 78	6 01
San Francisco	5 82	5 79
Total	6 02	6 01

It will be seen from the above that during 1920 the average rate charged by New York was higher than that charged by Dallas, the same as that charged by Atlanta, one one-hundredth of 1 per cent less than that charged by St Louis, and sixty-eight one-hundredths of 1 per cent lower than that charged by Kansas City. In 1921 the average rate charged by New York was higher than that charged in Atlanta, St Louis, and Dallas, and only eight one-hundredths of 1 per cent lower than that charged by Kansas City.

Respectfully submitted,

EDMUND PLATT,
Acting Governor

The President of the Senate

CHAPTER LX

THE INFLATION PERIOD¹

Conservation of Credit

With the opening of the year 1920, the federal reserve system had reached a new stage of its career in which it might have had as its principal duty and function the conservation and proper apportionment of banking credit. This it had never been able to exercise, notwithstanding that it was created primarily for that purpose. Not only had unprecedented conditions surrounded its operation, but there was still difference of opinion among expert authorities regarding the best method to be employed in carrying out the purposes of the system. Yet upon the success of the federal reserve banks in performing their function of credit conservation depended essentially their ultimate serviceability. Most of those who had urged what was called banking reform prior to the inauguration of the federal reserve system seemed to conceive of a new system as a means of emergency relief rather than as a regular factor in the banking organization, functioning steadily as a part of the credit mechanism of the country. A study of the Federal Reserve Act, however, shows that it was never intended to confine itself to any such sphere of action, as is thus indicated. Its purpose was that, above all else, of supplying a means of credit control—a mechanism by which the supply of credit might be automatically contracted or expanded as the business conditions of the country required. Could the system now resume its original end or must it remain an emergency expedient?

¹ In preparing this chapter, use has been made of a paper (written by the author) entitled "The Control and Apportionment of Credit," prepared for and published by the Bankers Statistics Company, 1920.

Era of War Finance

It has often been stated that the federal reserve banks never actually gained control of the discount market through the use of their rate power until a few months before the United States became a belligerent. The early period, lasting during the years 1915 and 1916, was only just beginning to be modified during the closing weeks of 1916. By that time industry had assumed much greater activity than was true during the first few months after the declaration of war in Europe. Great orders placed in the United States by the allied powers had built up enormous munitions-making establishments and had largely stimulated production of almost every staple and essential commodity.

The transfers of reserve balances from member banks in the cities to federal reserve banks had proceeded without embarrassment, and when Congress by law authorized the immediate transfer of the remaining balance, not the slightest difficulty was experienced. During 1915 and 1916, however, the surplus lending power which had been developed under the terms of the Federal Reserve Act was thus being gradually brought into play, so that at the opening of the year 1917 we had reached a point at which the discount rate of the federal reserve banks was beginning to have direct relationship to the rates charged by commercial institutions. Immediately upon our entry into the war, this condition was again profoundly altered, and for three reasons, already fully set forth but worth restating here for the sake of clearness:

1. Congress by the law of 1917 had relaxed the reserve requirements by cutting the percentage of reserves to 13 per cent in central reserve cities, while it exempted member banks from the necessity of holding vault reserves.

2. The development of a strong public opinion in favor of the depositing of specie with reserve banks and adverse to the hoarding or actual circulation of such specie, likewise had an important influence in removing from banks the element of

control or restriction to which they would ordinarily be subject by reason of the calls of customers for actual money

3 The suspension of gold and silver exports which followed not long after the declaration of belligerency and somewhat later the control over foreign exchange which was instituted under legislation adopted by Congress, still further tended to relax the various checks and balances whose influence was ordinarily so strongly on the side of credit restriction

New Relation to the Public

Due to these three factors, as well as others of important nature, the banking system of the country was given an entirely new relation to the public in which it was largely released from the usual tests of soundness. Such release in itself, or any condition like it, must always bring its own hazards, but when there were successively added the enormous credit demands of the government and the requirements of foreign countries which the United States undertook to finance, the basis of our commercial credit was completely altered. That basis was now shifted from commercial paper to government obligations. At the time the United States entered the war as a belligerent, the holdings of federal reserve banks, although relatively small, consisted entirely of commercial paper, while the reserve held was near 85 per cent. At the close of 1919 the evil had been still further aggravated and the portfolios of the reserve banks were largely war paper, their bill holdings consisting of this kind of asset to the extent of 50.5 per cent. Although the reserve banks were the holders of vastly more gold than they were in the middle of 1917 (\$2,041,000,000 as against \$1,212,000,000 on June 22, 1917), their reserve percentage was only about 45 per cent. This decline indicated the gradual seeping into the banks of non-liquid paper—paper, that is to say, not settled for or liquidated out of the proceeds of current industry, but representing a steadily increasing burden of outstanding claims.

The effect of the war and post-war financing can be reviewed in the following table (in millions)

	Apr 5-6 1917	Dec 27 1918	Jan 4 1920
Total cash	\$ 962 7	\$2,146 2	\$2,121 2
Net deposits and note liabilities	1,136 8	4,238 1	4,849
Required reserve	416 7	1,619 6	1,847
Reserve percentage	84 7	50 6	43 7
Earning assets	225 6	2,318 2	3,181 8
Reserve notes	400 7	2,855 6	2,998 9

Discussion of Inflation

The question whether ordinary banking methods would now suffice to correct this situation was clearly urgent. Not a few old-line bankers were still of the opinion that traditional methods would do the work.

"The only effective measure," said Mr. James B. Forgan, "available to the federal reserve banks should be applied, viz., to raise the discount rates on all lines of paper discounted by them." This policy had, however, been adopted so far as removing the preferential rates on loans secured by government obligations was concerned and had already had the effect of reducing somewhat the volume of such loans. But this had practically been offset by an increase in commercial paper re-discounted and bankers' acceptances. Mr. Forgan further suggested that "the policy of the member banks should be to discriminate against all loans for speculative purposes and to make careful investigation as to the use to be made of all moneys borrowed from them by their customers." These were useful suggestions—the question then being how and in what measure to apply them. Rates of discount at federal reserve banks had of course been advanced steadily during the war as rates on Treasury obligations advanced, while since the position of the Treasury in the money market altered, rates had been at least three times advanced. The general rates pre-

vailing in the system at the opening of 1920 were from $5\frac{1}{2}$ to 6 per cent, according to maturities, while those in effect on January 1, 1917, ranged from 3 to 5 per cent, 90-day commercial paper being at 6 per cent as against 4 and $4\frac{1}{2}$ previously. An actual beginning in the advance of discount rates occurred on November 4, 1919, but since that time the expansion of loan application had nevertheless continued. The expansion of federal reserve notes had reached a total of about \$3,000,000,000, or an increase of something like \$372,000,000 during 1919.

There was confusion of thought with respect to the question whether the immense demands for bank credit and the extension of loans based upon unliquid securities resulting from the war caused high prices which in turn necessitated a large increase in circulating medium, or whether the increase in circulating medium was itself the primary cause of the high prices. On all these points the facts were readily available and statistical study and investigation may be relied upon to develop them. What was of immediate interest is the fact that discount rates had been advanced as rapidly as public financing would permit and were at length being placed upon a commercial basis, independent of public finance requirements, these having been for the time being satisfied. Foremost for discussion now were the questions: What were the real fundamentals of a peacetime banking policy? How rapidly and how far could rates of discount be advanced, and would these advances alone suffice to meet the requirements of the situation, thereby laying the foundation for a return to the earlier reserve position?

Use of Discount Rates

The federal reserve system found itself, upon the return of peace, facing the real problems which it was originally created to deal with, but facing them in a way and under conditions which were never anticipated and immensely more difficult than

could ever have been expected or predicted. It should be emphasized, however, that the problems to be met were, in fact, peace problems and that they must be met by those banking methods which had been made familiar during long experience in the theory and practice of banking under peace conditions. The conditions produced by war, in so far as they rested upon governmental methods of control or restriction, had been altered. The United States was again a free gold market and there was nothing to prevent the free exportation of the precious metals. Indeed, it had during the last half of 1919 lost more than \$280,000,000 of gold through shipment abroad. On the other hand, it had ceased to exercise any control over the issue of new securities or the incorporation of new companies. The restraint upon stock exchange speculation which was exercised by the so-called Money Pool Committee had been abandoned early in the spring of 1919. It was not likely again to be resumed save under wholly extraordinary and at present unpredictable circumstances. Among the peace problems that had to be met by the federal reserve system were accordingly those which are always met by any central reserve banking system, and were as follows:

- 1 Regulation of rates of interest in such a way as to apportion credit along beneficial lines and to prevent undue diversion of capital into channels which might prove injurious rather than helpful
- 2 Regulation of the movement of specie into and out of the country
- 3 In connection with the specie movement, regulation or supervision of rates of exchange, and conditions under which foreign exchange business is carried on

These problems were practically contemporaneous with the organization of banking upon its present basis and the development of the problems of banking along modern lines. There were various obstacles to the handling of these questions by

federal reserve banks through the use of the recognized and traditional methods. Such obstacles, however, were not insuperable.

Discount Rate Policy

The foremost method which is employed by a central reserve bank in the performance of its function in relation to other banks and to the country at large, has in the past been the regulation of rates of discount. Of the practice of such regulation, the Bank of England probably furnishes the most complete and well-developed example. It has been the habit of the Bank of England during its long life to establish rates of discount upon such a basis as to lead the market. An increase in the rate of discount at the Bank of England accordingly means the expression of a belief that credit is being too freely used by the commercial lending institutions of the country, while, on the other hand, a decrease in the rate of the Bank of England is equivalent to the expression of an opinion that credit may be more freely employed. During the period of our active belligerency no such leadership could be exercised by federal reserve banks for the reason already mentioned, that to apply this method would have necessitated the establishment of rates without reference to the rates of interest which were borne by government bonds and certificates of indebtedness. It was the policy of the government to keep the latter rates down to a moderate figure, and had it been evident that banks which purchased such interest-bearing securities would lose money through rediscounting at a higher rate with federal reserve banks, very much more difficulty would have been experienced in the sale of such certificates to the banks and incidentally in their sale to individuals.

There was, therefore, during the war a wholly unprecedented and novel condition of affairs tending to check, if not absolutely to prevent, the use of changes of discount rates in money market leadership. The nation had only just wiped out

the vestiges of this system by abolishing the preferential rates which had given to paper collateralized by government obligations the advantage over commercial paper, but could it reintroduce the European mode of control?

The question asked by very many who had lost confidence in the working of the ordinary banking machinery largely as a result of long disuse or lack of familiarity with its methods, was whether a discount rate policy would succeed in attaining the same objects that had been accomplished by it in former years. The answer to this doubt or question can be given only when there is a clear understanding of the exact object to be sought. Those who doubt the efficacy of higher rates as a means of controlling excessive credits usually suggest that there is no reason to think that any ordinary advance in a rate of rediscount amounting to even 1 or 2 per cent will suffice to dissuade men from speculative operations in which they may profit to the extent of many per cent in a single day. This statement, of course, is true as far as it goes, but has very little bearing on the situation.

Function of Rate "Control"

Reserve banks were never supposed to control or regulate the amount of funds used in speculation by raising their rates so high as to make it unprofitable to borrow money for speculative purposes. What they were expected to do was to control the total volume of credits in such a way as to proportion it to the business and reserve position of the country—a very different undertaking. Reserve holdings by the federal reserve banks, for example, may be very low, and yet it may be entirely conceivable that the member banks of the country have abundant funds on hand and that they may therefore be able to extend credits or loans for speculative purposes at comparatively low rates of interest, as was true during the early years of the federal reserve system.

If, however, a condition exists in which most or many of

the commercial banks of the country are habitually resorting to the central institutions for discounts, low reserve percentages or the reduction of reserve means that credit is expanding and that the expansion is being directly based upon the ultimate reserve of the community. Such expansion may be brought about by speculative demands, although the member banks may be in possession of commercial paper which they are rediscounting, the funds being used to sustain speculation. In this case it may also be true that rates for call funds are moderate. An entirely different situation prevails when member banks have no spare or floating lending power and when the demands of their commercial clients are such as to absorb the proceeds of the rediscounts which they obtain from the central institution. In these circumstances (stock exchange paper not being directly rediscountable at reserve or central banks), the decline of the reserve percentage necessarily means a shortening of the funds which can be used in speculation, and consequently an advance in rates.

High Call Funds

Such an advance in rates has no relation to the rate at reserve banks. The latter might conceivably keep their rates at ordinary figures but refuse absolutely to discount more than a limited volume of paper for individual member banks, and the incidental consequences of such action might be even more pronounced than those of an advance in rates. Ordinarily, however, the advance in rates is the most equitable and most easily understood mode of controlling the supply of credit. Such advances are small because they have to do with the commercial rate and not with the speculative rate. The latter is dependent entirely upon the surplus or margin of lending power which is available in the commercial banks engaged in making loans of this description. In ordinary circumstances discount rate advances are closely watched and have an important influence, because it is believed that they correspond to or foreshadow

a shortening of credit which results in limiting the volume of speculative loans

At the regular meeting of the Federal Advisory Council on November 21, 1918, the question was asked by the Federal Reserve Board, "Should the main reliance of the reserve system be the adoption of the English practice of regulating the flow of gold by a variable discount rate?" The Council replied "The main reliance of the federal reserve system should be the adoption of the English practice of regulating the flow of gold by establishing a variable discount rate" In line with this recommendation, increases in discount rates have been authorized by the Federal Reserve Board, and Governor Harding advised a bankers' conference in session at Washington that "It is going to be necessary perhaps to raise rates beyond their present levels A further rate increase is a contingency which must be reckoned with"

Rationing and Distributing Credit

During the war we had become habituated to a banking policy which was designed to act as a substitute for the market leadership that is afforded by changes in discount rates This was the so-called "rationing" of credit which was seen in its most characteristic form in connection with stock exchange loans As there applied, the policy involved a maximum limitation upon such loans fixed by reference to the amount of business which was being conducted at a specified date by each prospective borrower, it being understood that borrowing should not exceed this normal or representative level, while in consideration of such limitation the rate of interest was held down to 6 per cent This kind of rationing had now been eliminated and the result was to release all over the country the lending power of the various banks and to promote its application to capital development and long-term lending, as well as to speculative uses Since the reduction of surplus reserves directed attention to the condition of af-

fairs in the banking system, it had been proposed in many influential quarters that the policy of rationing should be re-introduced in order to avoid an overgrowth of loans and thereby to bring about credit contraction. The thought that such rationing could effectually be practiced was based upon the success attained in that connection during the war.

It should, however, be remembered that whatever success was then attained depended entirely upon the fact that business was also rationed. Merely to ration credit or lending power, while leaving the disposition or application of such credit entirely in the hands of those who receive it, practically left to them the disposal of the credit as they saw fit. They might therefore apply it still further to the uses which were causing trouble and might thus continue to produce such trouble even though upon a lowered or lessened basis. Too much emphasis could hardly be placed upon the view that mere rationing of credit in respect to volume would not solve the difficulty, and that what was needed was the limitation of the use of available funds so as to confine them to the purposes of commercial banking, thereby reducing the inflation which follows from the improper use of such rates.

Limitation of Eligibility

No discount rate policy can, indeed, be "effective" in the sense in which that term is correctly employed, unless the bank which makes the rate acts upon a fairly strict and narrow definition of eligibility. In the Federal Reserve Act "eligible" paper was recognized as being solely that paper which grew out of live commercial transactions of agricultural, industrial, or business nature. The banks were permitted to trade in or discount paper based upon government bonds, but this permission had been availed of as the basis for transactions which had come to be the staple of business at reserve banks. Some of these transactions were of a commercial nature, business men finding it cheaper (until the elimination of the pre-

ferential for government obligations) to get discounts upon notes collateralized by such government obligations, other transactions had been purely speculative, and still others on the border-line—unlikely to be eligible in any sense of the word.

The essential point in this limitation of eligibility is to be found in the fact that whereas eligible paper provides its own means of payment through productive operations and thus automatically contracts as well as expands, paper of other kinds is not thus regulated and the credit based upon it may exist indefinitely with nothing to produce contraction. A mere change in the discount rate will not, therefore, be effective in heading off or curtailing the growth of credit when such credit is merely a conversion of government obligations into direct purchasing power. During the period of our belligerency we allowed practically any paper collateralized by government obligations to be admitted to discount. We thus weakened and relaxed our power over the volume of credit and shifted our central bank portfolios from a purely commercial basis to one which at best was composite and at worst was purely a government obligation basis.

This action, as already intimated, originated in the belief that it was necessary in order to enable the member banks to take care of the requirements of bona fide subscribers to government bonds who needed the aid of the banks in order to pay their subscriptions. Whatever the justice of this view may have been when the policy was first adopted, it had no basis after the subscription period had passed. For many months past, the chief justification for discounts based upon the direct notes of banks collateralized with government obligations had been the fact that unless the banks had this concession or consideration they would not be able to lend freely to the government. It was a question of relatively cheap credit for the meeting of Treasury needs. With the gradual withdrawal of the department from the money market, however, this condition of affairs changed and it became possible

once more to apply the rule of eligibility in purpose if not in the form of paper with greater strictness. Unless, indeed, this rule were in fact to be applied with decided rigidity, it might well be questioned whether any control through discount rate changes would be successful in its operations.

Relation to Foreign Exchange

But the system was not, after the close of the pegging of exchange, controlling foreign exchange rates through the use of the discount policy. From some standpoints it had not been necessary to do so. The abnormally low rates of exchange which exist in trade with most countries are in themselves such a barrier to the movement of coin out of the country that nothing more is perhaps needed for the time being. This, however, was a situation which could not be expected to last indefinitely. It was, moreover, already apparent that exchange relationships were very different with respect to the European neutrals and with respect to the former belligerents, while those with Oriental countries were in a class by themselves. Just as our exchange situation tended to prevent the sale of goods in Europe, so it tended to stimulate the sale of goods in the Orient. The federal reserve system had never at any time attempted to exercise a vigorous share in foreign exchange transactions. Indeed, at one time the Federal Advisory Council took ground against its doing so, but later adopted a resolution (November 21, 1918) to the effect that it should buy and sell foreign bills "as a means to regulate the exchange market and to control gold."

Nor were the member banks showing the power to deal with the foreign exchange situation in any satisfactory way. While some were extending large credits, others were actually short of exchange. There was a very wide divergence of practice among them, and most important of all, there was no uniformity of policy with respect to the extension of credits. This meant that our foreign credit situation was in a decidedly

haphazard condition Secretary Glass, in his annual report for 1919, stated the actual amount extended to foreign countries since the armistice at about \$2,329,000,000 Our net merchandise balance for the year 1919 was estimated at about \$4,000,000,000 A sum of about \$1,700,000,000 thus remained to be accounted for in connection with the year's financing, and it must be assumed that, apart from some very limited sales of bonds and other obligations, this had been done largely by actual exporting houses which opened credits As trade with other countries proceeded it clearly became more and more necessary to apply central banking methods in the development and regulation of our foreign business Federal reserve banks were buying acceptances stated in dollars and growing out of foreign trade, but they had neither developed their connections abroad nor enlarged the scope of such business at home to a point that would enable them to exert much influence in determining or controlling the distribution or apportionment of credit as between domestic and international business, or as between the various foreign countries which seek commercial accommodation in this market Yet the adoption of the well-recognized relation to foreign trade referred to by the Federal Advisory Council must inevitably come as an element of a peace banking policy Thus, it was plain, a broader market for foreign paper, a more highly developed participation in the foreign field, would clearly be necessary if we were to carry the share of world trade usually regarded as ours

Summary

It had grown clear that the policy of our banking system must include as its cardinal principle the reduction of the total amount of credit granted because of the fact that such credit was being so largely employed for purposes of exploitation and speculation, for the hoarding of goods, and for the artificial raising of prices This limitation of the total volume

of credit meant contraction, and contraction brought as a concomitant lower prices. Reduction of prices invariably hurt some of those who had been building their prospects upon the idea of continued high or rising prices. But there was a very great difference between the groups or classes of persons who might thus be injured. Contraction should always be brought about in such a way as to do the least injury and to involve as small an amount of readjustment as practicable. Such restriction of the harm or danger following from contraction is best obtained by the gradual but effective reintroduction of strict standards of eligibility in paper. These standards should be such as effectually to eliminate purely speculative or long-term loans, and to prefer those whose purpose it is to carry on the operations of active business. It was a mistake to suppose that a mere rationing of credit in amount could be effective as a substitute for the idea of eligibility, although it might at times be necessary to employ the idea of rationing or restriction in order to penalize those who have shown too great a disposition to enlarge their commitments at the expense of other borrowing institutions or of the central reserve institutions.

Rationing, in short, aims at an object which is far better attained through strict interpretation of eligibility. This thought applied in connection with foreign trade financing at once suggested the idea of discriminating between that part of our foreign trade based upon short-term, live, available credit and that which represented long-term accommodation credit or capital investment. It is not wise, as noted again and again, for American banks to attempt to absorb any considerable amount of the latter kind of credit, even though their refusal to do so meant a reduction in our export trade. On the other hand, it was much to be desired that they should freely assist in the financing of the paper growing out of the bona fide short-term export transactions, even though such action might expose them to some danger of loss in connec-

tion with the depreciation of foreign currencies. Such operations required the leadership and assistance of federal reserve banks if they were to be carried on for a consistent purpose or in pursuit of a uniform policy. Higher rates for credit, curtailment of speculative loans, adjustment or apportionment of available resources between industries and between domestic and foreign trade demands, were thus indicated as the necessary and outstanding features of our banking policy during the later months.

CHAPTER LXI

HIGH PRICES AND FOREIGN TRADE

Edge Law Ineffectual

The plan to finance foreign trade after the armistice by means of a special type of financing to be organized under the so-called Edge Act, has already been described. This method had, however, as already seen, been unsuccessful. It was not clear during the early part of 1920 what would be the fate of the Edge Act, for an entirely insufficient time had been afforded to permit the organization of institutions under the new law. What did very clearly appear was that, even if the law had been well adapted to conditions, it had probably come too late. The financing of foreign trade by other means was already under great headway and was apparently proceeding successfully so that an impetus to the creation of new institutions could hardly be obtained save through some outside influence which was not yet at work. Whether such an influence might have been afforded had there come no sudden check to prosperity, may be fairly questioned, but, as already seen in earlier chapters, the structure of credit was becoming so heavy and the upward movement of prices so extreme that it had become plain to the discerning by the spring of 1920 that reaction was almost certain to set in.

Congestion of Products

Probably the first symptoms of impending difficulty were found in the great congestion of products. Such congestion had become very severe in certain parts of the country with reference to agricultural commodities. Banks, far from con-

stricting agricultural credit, had been too free with it and had allowed the development of an extensive hoarding movement to occur. This gave rise to an inflation of a dangerous kind, banks lending very freely upon stored commodities. Such commodities were not always stored at points of production, but in not a few cases represented accumulations at primary markets or financial centers. Such accumulations had occurred in almost every branch of basic industry. There was an oversupply of many commodities which had been carried over from the war. The government itself had enormous hoards of both raw and manufactured goods, and these hoards were only a fraction, probably, of those which were held by private concerns. Manufacturers on a large scale, seeing no limit to the advance of prices and believing that postponement of their essential requirements would result in the necessity of paying still more dearly for what they needed, had accumulated great quantities of raw materials. Retailers, frightened by the apparent difficulty in obtaining delivery of finished products, had resorted to the plan of placing orders with a number of concerns simultaneously, trusting to obtain a percentage from each. Thus there appeared to be an immense volume of buying orders all over the country.

This volume of orders was in many cases far ahead of what concerns could supply, and gave the impression to their bankers that the stocks they had on hand were not in great surplus and by no means to be deemed oversufficient to their early necessities. Hence the further extension of credit not only upon local raw products, such as cotton, wheat, and the like, but also upon imported staples, such as rubber, hemp, and others, while at the same time large extensions of credit based upon copper, steel and the manufacturers thereof, leather, and even upon furs and articles of luxury, had come into existence. Altogether the situation was thus suggestive of possibilities of extreme danger.

Effect of Congestion

This condition of affairs was brought to a head domestically by the railroad congestion which occurred throughout the country in the late winter of 1920 when many shipments of goods remained stored in the cars and unable to move, thus necessitating still longer extensions of credit and rendering the delivery of goods more difficult. The condition thus developed might easily have been overcome had it not been true that similar conditions had developed abroad and had been brought almost to the breaking point. It had become evident that if at any time there should be a distinct check to consumption or purchase, the effect would be to cause a great collapse in the volume of orders and thus to limit the extension of accommodation very sharply.

Such a situation was precipitated comparatively early in the year by a movement which developed first abroad and then spread rapidly throughout the whole world. Apparently a beginning was made in Japan where extensive speculation in silk and in other local products, accompanied by great advances in the cost of consumable commodities, had created an embarrassing situation. At the same time great accumulations of silk in New York, carried by means of bank loans, tended to aggravate the state of things here and establish a condition of weakness and danger which was likely to yield to any severe shock. Such a shock was administered by the reaction which set in at the principal Japanese markets and resulted in disorganizing the price of silk and silk goods throughout the United States. In European countries the shutting off of the supply of credit which had come from the United States as the result of government extensions, produced somewhat the same state of things, and shrinkage of demand, followed by price recession (measured in gold), began to appear in most countries at or about the same time. This movement can best be understood by a comparison of

WHOLESALE PRICES ABROAD*
INDEX NUMBERS OF WHOLESALE PRICES (ALL COMMODITIES)
(1913 = 100)

	United States, Federal Reserve Board (90 quotations)	United States, Bureau of Labor Statistics (328 quotations)	United Kingdom, Statist (45 commodities)	France, Bulletin Statistique Generale (45 commodities)	Italy, Prof. Bachi (40 commodities)	Sweden, Svensk Handelstidning	Japan, Bank of Tokyo (56 commodities)	Australia, Commonwealth Census and Statistics (92 commodities)	Canada, Department of Labor (72 quotations)	Calcutta, India, Department of Statistics (75 commodities)
1913	100	100	100	100	100	100	100	**100	100	1100
1914		100	101	101	95	116	96	141	101	
1915		101	126	137	133	145	97	141	110	
1916		124	159	187	202	185	117	132	135	
1917		174	206	262	299	244	149	155	177	
1918		197	226	339	499	339	197	170	206	
1919										
July	212	218	243	349	359	320	247	176	218	
August	218	226	250	347	368	321	251	182	223	204
September	212	221	252	360	370	319	257	185	223	200
October	212	223	264	382	388	307	271	200	222	
November	219	230	271	405	436	308	280	199	227	
December	224	238	276	423	455	317	288	197	240	
1920										
January	242	248	288	487	504	319	301	203	248	218
February	242	249	306	522	556	342	313	206	254	209
March	248	253	307	555	619	354	321	209	258	198
April	263	265	313	584	679	354	300	217	261	200
May	264	272	305	550	659	361	272	225	263	210
June	258	269	300	492	614	366	248	233	258	206
July	251	262	299	462		364	239	234	256	209

*The index numbers were constructed by the various foreign statistical offices according to methods described in the *Federal Reserve Bulletin* for January, 1920. In all cases except that of the United States the original basis upon which the index numbers were computed was shifted to the 1913 base. The monthly and yearly index numbers were therefore only approximate. The latest figures were received by cable and were subject to correction.

**July, 1914 = 100.

†End of July, 1914 = 100.

‡Last six months of 1917.

price indexes for various countries, furnished in the preceding table published in the Federal Reserve Bulletin ¹

"Buyers' Strike"

This state of things was contemporary with a so-called buyers' strike in the United States. The term "buyers' strike" has often been loosely used as if it implied an organized attempt or decision on the part of consumers to discontinue purchasing. There was, of course, no basis for any such assumption. Extraordinarily high prices had, however, outrun the buying power of large classes in the community. Those with fixed income, the professional classes and many others, found their funds equal to but little more than one-third what they had been a few years previously. During the height of the war and immediately after it, many had drawn upon their accumulated savings in order to carry them through the crisis or to provide funds needed on account of the absence of members of the family who had been wage-earners but who had found it necessary to enter government service on account of the draft or had voluntarily given themselves to such service. There was necessarily an end to this kind of buying and it came, as all such changes do, rather suddenly.

A marked falling off in demand for commodities was noted during the spring of 1920 and was met by some farsighted merchants by prompt cuts or reductions which enabled them to work off their surplus products. This, however, was possible only in a minority of cases. In most instances no such way of bridging over the difficulty was feasible. Concerns which, like the great leather companies, had enormous accumulated stocks which they had purchased at high prices in order to be sure of abundant material, found their supplies greatly reduced in value, and this reduction continued steadily throughout the remainder of 1920, largely because of the fact that as demand fell off, more and more supplies of commodities were released

¹Federal Reserve Bulletin, September, 1920, p. 953

in order to realize immediate cash funds, so that, as is always the case in such circumstances, the fall of prices gained momentum and index numbers moved steadily on down toward lower levels

This change inevitably wrought havoc with balance sheets. In many cases, even of concerns which had enjoyed the best business management, surpluses were completely wiped out when new inventories had resulted in adjusting values to market quotations. The fact that the situation was world-wide, greatly aggravated conditions in the United States because of the extreme dependence upon foreign trade which had developed as a result of the war. Great quantities of goods which had been shipped to supposedly responsible buyers in foreign countries were rejected so that they remained on the hands of the exporters' agents. Many exporters had financed themselves by discounting drafts drawn upon foreign buyers, their banks, however, retaining a recourse upon them, so that when the buyers abroad dishonored the drafts and rejected the goods, these drafts returned home and were charged off by the banks against the accounts of the exporters. A very severe shock to manufacturing was thus administered, with the result that the volume of production steadily declined pending the time when congestion could be relieved through a broader consumption.

Board's Discount Policy

As the spring of 1920 had advanced, the necessity of checking inflation in some way had become more and more evident and rates had been advanced to what was to be their maximum point, this level being arrived at in June. It will be noted that the advance thus made, however, came distinctly after the turning of the tide and had no relation whatever to it. Even if the moderate advances in rates effected in November, 1919, be considered as having exerted a direct influence upon foreign trade financing, it would require some exercise of the imagination to suppose that as the result of this very moderate increase,

demand had been checked all over the world during the succeeding six months. Reference is often made to the psychology of the Board's policy, the advance in rates being regarded as "giving the signal" for restriction. The "signal" had been more truly given by the commercial banks themselves, which had found themselves greatly inflated and extended with doubtful loans and dangerous elements of paper in their portfolios. During the year 1920 many banks were making efforts to save the situation, and from the middle of 1920 until a year later there was at times very serious doubt as to whether some large institutions might not be forced to the wall. For the Board in these circumstances to attempt a restriction of credit would have been suicidal, and in fact it did not do so,

FEDERAL RESERVE BANKS' TOTAL HOLDINGS OF DISCOUNTED BILLS
COMPARED WITH HOLDINGS OF DISCOUNTED BILLS SECURED BY
GOVERNMENT WAR OBLIGATIONS (JANUARY, 1920, TO MAY, 1921)

	Total hold- ings of dis- counted bills	Index of total hold- ings of bills (average 1920 = 100)	Holdings of discounted bills secured by Govern- ment war obligations	Index of bills secured by Govern- ment war obligations (average 1920 = 100)	Ratio of bills secured by Government war obliga- tions to total bills, in percentages
1920					
Jan 30	\$2,174,357	85 0	\$1,457,892	109 5	66
Feb 27	2,453,511	96 0	1,572,980	118 1	64
Mar 26	2,449,230	95 8	1,441,015	108 2	59
Apr 30	2,535,071	99 1	1,465,320	110 1	58
May 28	2,519,431	98 5	1,447,962	108 8	57
June 25	2,431,794	95 1	1,277,980	96 0	53
July 30	2,491,630	97 4	1,241,017	93 2	50
Aug 27	2,667,127	104 3	1,314,830	98 8	49
Sept 24	2,704,464	105 8	1,220,423	91 7	45
Oct 29	2,801,297	109 6	1,203,905	90 4	43
Nov 26	2,735,400	107 0	1,192,425	89 6	44
Dec 30	2,719,134	106 3	1,141,036	85 7	42
Average for 1920	\$2,556,871	100 0	\$1,331,399	100 0	52
1921					
Jan 31	\$2,457,116	96 1	\$1,040,365	78 1	42
Feb 28	2,389,510	93 5	997,968	75 0	42
Mar 31	2,233,104	87 3	970,961	72 9	43
Apr 30	2,076,569	81 2	937,652	70 4	45
May 31	1,907,913	74 6	790,744	59 4	41

figures showing, as has already often been remarked, a steady advance of commercial credit up to the close of the year, notwithstanding decline in collateral loans based on Liberty bonds and government notes. At the risk of repetition the above tabular view² is inserted in order to emphasize this point.

Foreign Trade and Domestic Business

The reaction which had thus set in from foreign sources, naturally reflected itself in domestic business, as has just been indicated. It did not, however, as some have supposed, affect the agricultural situation in any direct way. Europe continued to need, and to purchase heavily of, American cotton, wheat, and other products, and these products continued to be financed in the usual way through bankers' acceptances and by ordinary loans of credit. There was never a time when the agricultural exporter could not get from his bank abundant credit for the shipment of his products to foreign countries, provided that he was willing to guarantee the payment of the bills at maturity. The problem lay not in the getting of credit, but in the fact that it was a very serious hardship for the farmer to adjust himself to the decline in prices which was now setting in and to the great restriction of foreign buying power and foreign solvency which had appeared as a direct result of the post-war changes in Europe. The United States, in short, was simply feeling the reflected effects of the European war which were showing themselves in the effort to get back to a sounder basis, to cease borrowing so far as practicable, and hence to discontinue buying indiscriminately in all the countries of the world at practically any prices that might be demanded.

This, however, was not understood by the farmer element, or, it should be added, by many manufacturers who now began to blame the supposedly restrictive efforts of the Board as well as the very moderate advances that had taken place in discount rates. A scrutiny of commercial rates throughout the country

² H. R. Report No. 408, 67th Congress, 1st Session

does not show that they were materially advanced in any quarter during this period, so that the connection between bank credit and business, even export business, was distinctly less direct than is usually true in such circumstances. It would have been a high tribute to the efficiency with which the federal reserve system was managed, had it been able to apply its advances in rates sufficiently early to prevent the growth of inflation and to cut off dangerous extensions of credit. As already seen, however, this was not feasible for two reasons—the continuance of the Liberty loan policy long after the war was over, coupled as it was with immense extensions of credit to foreign countries, and secondly, the lack of facilities on the part of the federal reserve system for operating in foreign countries or for exerting any direct influence whatever over the financing of exports.

About all that can be said for the federal reserve system during this period is that with its great strength, enhanced as it was by tremendous net imports of gold during and after the war, it was able to supply credit to any legitimate borrower, and that there was never a time when symptoms of panic or uncertainty exhibited themselves either among the banks or among the business public. Such fears for the future as existed were found entirely in connection with the conditions of demand and of prices, influenced primarily, of course, by the revolution in foreign buying power which had set in. The foreign trade of the country, in a word, was being subjected to the same process of “house-cleaning” and reorganization that had already begun in the stock market, and this process continued steadily throughout the year 1920 and well into the year 1921, comparative stability of prices being reached at about the middle of the latter period, while foreign trade had been sharply cut back and the basis of foreign credits entirely altered. The mortality among export and import houses was tremendous, as the statistics for failures clearly show, while the general reaction as reflected in failures was almost unpre-

cedented⁸ Had it not been for the ability of the banks, backed by the federal reserve system, to "carry" all houses, whether

⁸ In 1919 the number of large failures had fallen to the lowest point in many years, but the number of such defaults during 1920 was the largest on record, and the liabilities were the heaviest since 1914. Numbering 453, the failures for \$100,000 or more in each case in 1920 supplied \$191,808,042 of aggregate indebtedness, as against 191 of such insolvencies in 1919, with liabilities of \$55,986,543. In point of number, the closest approach to the unfavorable showing of 1920 was in 1914, when 409 large defaults were reported, and the indebtedness of such reverses in that year was \$210,700,000. By far the largest proportion of the reverses of unusual magnitude in 1920 occurred in manufacturing lines, where the failures for \$100,000 or more in each instance numbered 230 and involved \$89,933,984 altogether, while there were 139 similar defaults among traders for \$34,609,853. The remaining 84 large insolvencies, with liabilities of \$67,264,207, were of agents, brokers, and other concerns that cannot be properly included in either of the two leading divisions.

In the following tables the figures, as compiled from the records of R G Dun & Co., are separated as to each of the twelve federal reserve districts, the number and amount of assets and liabilities in each district for 1920 compared with the number and liabilities in 1919, also the record for each district for 1920 separated as to manufacturing, trading, and other commercial.

FAILURES IN UNITED STATES DURING 1920
TOTAL COMMERCIAL

District	1920			1919	
	Number	Assets	Liabilities	Number	Liabilities
First	826	\$ 8,111,364	\$ 18,918,258	744	\$ 11,884,238
Second	2,123	69,081,128	118,850,529	1,185	32,413,538
Third	419	10,189,729	16,888,034	360	6,863,575
Fourth	692	13,663,472	14,327,557	567	13,329,257
Fifth	538	9,918,701	13,100,323	355	5,605,832
Sixth	597	9,349,352	11,657,425	455	5,928,220
Seventh	988	27,423,147	39,513,647	770	12,717,628
Eighth	457	8,006,285	9,456,219	359	4,021,861
Ninth	247	2,670,329	4,573,594	149	1,223,952
Tenth	375	8,610,102	10,190,370	271	3,287,855
Eleventh	475	8,939,537	11,219,010	322	3,884,398
Twelfth	1,144	18,540,968	26,426,839	894	12,130,883
Total	8,881	\$194,504,114	\$295,121,805	6,451	\$113,291,237

CLASSIFIED FAILURES, 1920

District	Manufacturing		Trading		Other commercial	
	Number	Liabilities	Number	Liabilities	Number	Liabilities
First	283	\$ 8,639,713	466	\$ 6,673,457	77	\$ 3,605,088
Second	835	47,075,153	1,094	24,876,882	194	40,898,494
Third	130	9,735,049	259	5,992,997	30	1,159,988
Fourth	197	7,901,729	439	5,530,319	56	895,509
Fifth	109	4,656,984	384	6,737,903	45	1,705,376
Sixth	105	3,032,079	456	5,657,981	30	2,967,365
Seventh	350	22,689,663	577	7,695,420	61	9,125,564
Eighth	79	3,906,414	355	5,199,005	23	350,800
Ninth	55	2,221,637	168	1,759,000	24	592,957
Tenth	78	5,401,143	271	3,838,793	26	950,524
Eleventh	53	4,775,574	390	5,466,989	32	976,447
Twelfth	361	7,957,333	673	9,129,631	110	9,339,875
Total	2,635	\$127,992,471	5,532	\$88,558,347	714	\$78,570,987

in the foreign or domestic trade, which possessed elements of soundness and gave promise of being able to recover in due time, the changes might have been almost revolutionary. The fact that they were not so must be attributed practically entirely to the work of the federal reserve system.

Turning Point Reached

A turning point in the situation had clearly been reached in the early autumn of 1920. Survey of the foreign trade situation from the statistical standpoint showed that even during the latter part of the fiscal year 1920, there had been decided reduction of our inflated foreign trade balance.⁴

The substance of the figures may be presented in compact form in the brief table opposite.

There were numerous factors which confirm the belief that our excessive export balance was in process of being still further curtailed. The very high prices which had prevailed in the United States for many months and which until recently had shown indication of advancing to still higher levels, undoubtedly tended to discourage a good many foreign buyers who would otherwise have sought to supply themselves in this market but who found it impossible to contend against the combined handicap furnished by the high domestic prices and the increment resulting from unfavorable exchange conditions. Shipping concerns testified that shortage of freight for export was more pronounced than for some time past, and while this was in part due to embargoes (or what amounts to such) upon coal and other heavy freight, as the result of the transportation "tie-up," there was every reason to ascribe it, in part at least, to the general competitive conditions already referred to.

In this same connection mention should be made of the fact that, as money stringency became more pronounced and rates higher, there was an increasing indisposition on the part of commercial banks to furnish financial facilities designed to

⁴Discussion from this point to the end of the chapter is taken from a statement prepared by the author for the Federal Reserve Board (See Bulletin, August, 1920.)

	June—	
	1920	1919
Imports		
Free of duty	\$277,000,000	\$195,519,458
Dutiable	276,000,000	97,366,085
Total	\$553,000,000	\$292,915,543
Exports		
Domestic	\$617,000,000	\$907,968,086
Foreign	14,000,000	20,411,117
Total	\$631,000,000	\$928,379,203
Excess of exports	\$78,000,000	\$635,463,660

	12 months ended June—		Increase
	1920	1919	
Imports			
Dutiable	\$3,405,235,628	\$2,230,222,808	\$1,175,012,820
	1,833,510,952	865,497,260	968,013,692
Total	\$5,238,746,580	\$3,095,720,068	\$2,143,026,512
Exports			
Domestic	\$7,950,335,672	\$7,081,461,938	\$868,873,734
Foreign	160,840,459	150,820,748	10,019,711
Total	\$8,111,176,131	\$7,232,282,686	\$878,893,445
Excess of exports	\$2,872,429,551	\$4,136,562,618	

take care of the movement of goods abroad. More conservative banking institutions engaged in the export trade took pains to cover their foreign exchange commitments as rapidly as they were incurred, and even in the face of the rather more stable conditions of exchange that prevailed during the latter part of June and the first weeks in July, they were disinclined to carry very large balances in foreign currency. Perhaps this indisposition to incur obligations on foreign exchange account

was as pronounced as at any time theretofore, if not more so. On the other hand, banking institutions expressly devoting themselves to foreign trade found it difficult to continue the extension of accommodation under as favorable conditions as theretofore. The sale of their acceptances—a resource upon which they necessarily relied in large part to carry on their operations—was naturally hampered by the high rates for money, while they found in some cases the effort to offer foreign balances as security unsatisfactory to local buyers of their paper. Such attempts as were made on a small scale to place foreign securities in the United States were successful only when a very high rate of interest was offered.

CHAPTER LXII

THE CHANGE IN TREASURY POLICY

A New Stage

The Treasury policy which had been so uncertain and variable for a long time past, was now to pass through another stage of its checkered career. Secretary Glass had determined to leave the Treasury and to enter the Senate, appointment to the latter body having been offered to him in the late autumn of 1919. President Wilson, as noted at an earlier point, determined to transfer Secretary of Agriculture Houston to the Treasury Department, and thus another mind was brought into the shaping of the post-war discount policy of the reserve system.

Mr. Glass's retirement had taken place just after the policy of advancing discount rates had been initiated. He had himself been always favorable to the view that the reserve system must get back to the pre-war level of charges, or higher if necessary, and that the extremely low rate policy initiated during the war could not last. Mr. Glass had also been consistently of the opinion that the preferential rates in favor of Liberty bonds and notes had no economic justification, notwithstanding that he had maintained the low discount rate policy and had supported the differentials in order to carry out the Fifth, or Victory Loan upon the basis which had been initiated by his predecessor. In this view of the situation the time had, however, come when a new policy could well be introduced. Secretary Glass had consented to the usual arrangements between the banks and the buyers of Liberty bonds whereby a low rate on Victory notes was practically guaranteed to the latter for a period of some months after the floating

of the Fifth Loan. It was the general opinion, however, that this agreement had been practically fulfilled with the opening of the autumn of 1919, while the rampant speculation to which reference has already been made at an earlier point, had already convinced everyone who was at all conversant with conditions that it would have been far better if the reserve banks had stopped all discounting at preferential rates at a much earlier time, and if they had in fact refused to discount paper with Liberty bond collateral except for the absolutely necessary purposes connected with the floating and absorption of the issues.

End of McAdoo Policy

It may thus be said that the McAdoo policy had been brought to an end with the culmination of the inflation period after the war and had been definitely terminated in November, 1919, when the first upward movement of discount rates occurred. This fact should be borne consistently in mind in estimating the services of Secretary Glass as the head of the Treasury Department. He has habitually been classed as simply a perpetuator of the McAdoo inflation policies, the facts, however, being as just outlined. The dropping of the McAdoo policies, it was well understood, would necessarily result in a change of front in many parts of the industrial world. Prices were almost certain to fall. Liberty bonds, of course, could not hope to be sustained in value after the close of the speculative period. They were already showing signs of sharp downward trend and it was only reasonable to expect that this movement would go very much further and would continue for an indefinitely long period. All this necessarily meant that the Treasury Department would be unable to finance itself on the cheaper basis of the past, and that it might even incur new difficulties of a sort not exactly to be foreseen in connection with its future borrowings.

This, however, was a part of the post-war reorganization which evidently would have to be met at some time or other

The autumn of 1919 was reckoned as good a time as any at which to begin it. Inflation had made terrible inroads into the business life of the country, yet the losses were not irreparable. Speculation had gone to extravagant limits, yet it had not ruined the banking structure. The essential basis of finance was still sound, or at all events possessed enough soundness to permit it to be salvaged. The Treasury itself, although facing tremendous outlays, had succeeded in cutting off the enormous drain caused by foreign loans and subsidies. It was still in the enjoyment of a large income from taxes. If a halt could be definitely called and a stop set to inflation, all might yet be well and the country might be saved from financial disaster which, however, was an evident possibility should conditions be allowed to continue as they were.

Policy of Secretary Houston

Secretary Houston entered upon office at the beginning of the year 1920, with these problems definitely in mind. He had resolved to eliminate the methods of government coddling and hothousing which had been so long in use, and to that end he first impressed upon the Federal Reserve Board the fact that he was entirely in harmony with a plan which would insist on higher discount rates and reduce advances for speculative purposes. He went further than this, for he himself also stopped the operations of the War Finance Corporation and particularly refused to give any further support for the inflated export trade interests which had been drawing heavily on the corporation and which desired to see still further work of the same sort undertaken. During the spring of 1920, Secretary Houston practically dissolved the corporation, or at all events reduced it to a mere skeleton organization with a view to ultimate dissolution. He reported fully upon this subject to Congress, stating his reasons for the action taken.

At the same time, in his flotation of Treasury certificates of indebtedness he was disposed to put them out on their merits

and to encourage the federal reserve banks in the policy of distributing them as widely as possible, not only among member banks but also among individuals. The certificate rate itself was raised from $5\frac{3}{4}$ to 6 per cent, while the rates at reserve banks were first raised from $5\frac{1}{2}$ to 6 per cent in January, and later in May and June to 7 per cent. At the same time reserve banks were admonished to stop lending for purely speculative purposes and to endeavor to get city banks to curtail the vast volume of rediscounts which they had taken on, in some cases up to an amount several times their capital. The Phelan Act, which had gone into technical operation, was suggested to the several banks as a means of applying the brakes, but was adopted, as stated before, only by four—St. Louis, Kansas City, Dallas, and Atlanta. It does not clearly appear whether Secretary Houston himself approved of the principles of the Phelan Act, but under his Chairmanship of the Board it was at all events vigorously put into operation at four banks and was recommended to others along the lines that had been mapped out by Governor Harding who had originally fathered the notions contained in the measure.

Refusal to Extend Foreign Credits

In another way the Treasury Department assisted toward the restoration of a normal state of affairs, although this was an inactive rather than a positive policy. The Department, as we have seen, had granted during the war loans to foreign countries which eventually had cost the disbursement of about \$9,500,000,000. Of this sum fully \$2,300,000,000 was transferred after the armistice and had the effect of extending foreign trade during the early part of 1919. Exactly how long these great sums actually spread themselves out through the credit mechanism and so served to finance large shipments abroad could not, of course, be stated. Probably some balances thus derived from the Treasury were still in existence in an unexhausted state on the books of American bankers, to which

they had been transferred, up to the end of 1919—possibly a little longer. The Treasury Department had early seen the unwisdom of continuing these advances any longer than necessary after the close of the war, and yet it felt itself bound by the obligations which had been entered into when the credits were granted. Foreign countries had incurred enormous obligations, largely in the United States. They could not cancel these obligations with a stroke of the pen but must settle for them. Manufacturers could not be expected simply to swallow tremendous losses but must count upon getting back at least sufficient to cover their outlays. This process of adjustment was actually in progress, all along the line both between our own government and domestic producers and between the latter and foreign governments, as well as jointly throughout all branches of trade and industry throughout 1919.

As the end of these great government credits drew near, foreign countries or their business interests began to develop a propaganda here in favor of a continuance of it, and in this they were joined by certain elements among manufacturers who foresaw the ending of a profitable trade since government support had been withdrawn. The Treasury Department might have advanced on the basis of existing credits a good deal more than it did, but both Secretary Glass and Secretary Houston emphatically assumed the position that no further extensions should be allowed, and that only the minimum amount necessary to fulfill obligations should be paid by the government. The step was not merely wise, it was absolutely essential and necessary if this country was to avoid the piling up of tremendous additions to its debt to an extent which perhaps could not be met, yet it was certain that this policy on the part of the Treasury would cut away a substantial amount of artificial demand for American products.

Attempt to Secure a Settlement

Hand in hand with the attempt to reduce the amount of new credits went the effort on the part of the Treasury Depart-

ment to obtain an adjustment of old orders. The foreign countries, when they at first received advances from the United States Treasury, had merely left informal acknowledgments of indebtedness with the Department, and it was now desired to fund these—that is to say, to exchange the short-term notes of an informal sort for regularly dated bonds which should specify in full the conditions of fees, payments, maturity of instalments or amortization settlements, and a variety of others. The matter was taken up by Secretary Glass with foreign governments as soon as was reasonably possible after the close of the war, but neither under his direction nor that of Secretary Houston was there much progress made. Premier Lloyd-George administered a sharp rebuff to Secretary Houston, practically cutting off negotiations for the funding of the British debt, apparently in the belief that a change of administration in the United States might be followed by the development of a more favorable attitude toward cancellation.¹ Other countries were far less complacent than Lloyd-George, since they showed indisposition to consider the subject at all, and were anxious to increase their debt to the United States rather than to arrange for paying it. The effort to obtain settlement, then, while it may have had some psychological effect both abroad and (so far as it was known) at home, did not result in bringing about any return of funds into the United States, and is chiefly interesting as indicating the change of attitude on the part of the Treasury Department which, instead of the prodigal policy pursued during the war, now began to return to a policy of conservatism and careful calculation of results.

All these things, however, were well known in official circles and had their effect upon the federal reserve system. The system had become abnormally sensitive to Treasury influence and point of view, as already seen in another connection. Changes in this point of view under Secretaries Glass and Houston diffused themselves promptly throughout the

¹ See testimony of Secretary Mellon in Hearings before Senate Committee on Finance, 1921 (World War Debt Funding Commission)

reserve system and brought about a reversal of attitude on the part of many officers. They began to look askance at the doubtful foreign trade acceptances and to question the various forms of foreign financing which had given rise to paper of an evidently non-liquid sort. The New York market had become overburdened with doubtful bankers' acceptances, long-term loans of various kinds, paper secured by balances abroad (in foreign banks), and other financial expedients of a dubious nature. It needed only some sharp criticism to awaken the financial community to the sense of danger involved in these measures, and the changed attitude of the Treasury, diffusing itself throughout the reserve banking system, undoubtedly tended strongly to bring about such a change of policy. All these factors, taken together, worked a great transformation in the credit situation, and, from the spring of 1920 onwards, there was a widespread feeling that the reserve banks, although amply able and willing to discount sound paper—indeed, while still increasing their loans and advances up to a peak point which did not come until the end of the year—were nevertheless setting their faces against extravagant and wild operations of the kind that had been common before.

Change in Bond Situation

This policy brought about a steady change in the bond and certificate situation. By the middle of 1920 the federal reserve agent at New York was able to report that certificates were now in a very large proportion passing into the hands of investment institutions and private holders. The process was slower in other banks but nevertheless made good headway throughout the country.²

The year 1919-1920 had, in fact, seen a material improvement in the war-paper situation in various banking institutions

² Conditions in the system at this time were discussed at length by the author in the Federal Reserve Bulletin, July, 1920, from which matter in the remainder of the chapter is taken.

In the federal reserve system, for example, the total holdings of paper secured by government war obligations have evidently passed their peak and begun to decline. The Board's statistical review for the year ending June 30, 1919, showed that on June 27 of that year the total volume of paper secured by government war obligations under discount was \$1,573,500,000, while at the close of June, 1920 (June 25), the holdings of paper secured by war obligations were approximately \$295,500,000 less than that figure. Member bank reports to the Federal Reserve Board showed that taking the returns from institutions in 100 selected cities, there were on June 20, 1919, loans secured by United States bonds and other war obligations,³ amounting to \$1,412,000,000, while the total of United States securities owned was \$2,337,000,000. The corresponding figures for June 18, 1920, show a very material decrease in the total amount of United States securities owed, while a corresponding decrease in the total volume of loans secured by government war obligations is likewise reported, the respective figures being \$742,388,000 of paper and \$1,587,832,000 of securities owned.

Unquestionable progress had been made during the period in reducing the total holdings of war securities, both under the form of ownership and under that of collateralized advances. This progress may be attributed in no small measure to the increasing rates of discount and interest which had tended to make it unprofitable for owners of government securities to continue carrying them through the medium of advances obtained from banking institutions. The experience of the year had shown that there was also continued danger of "inflation" to be seen in the growth of loans secured by other stocks and bonds which represent advances made by the banks to borrowers who desired in many cases to obtain a comparatively long-period accommodation.

³ Exclusive of rediscounts with federal reserve banks

Working of Credit Control

Question has been constantly asked regarding relationship between control of credit, the application of higher discount rates, and the actual expansion of operations. On this subject the evidence was still lacking in certainty as to details. The general conclusion to be drawn was unmistakably to the effect that the operation of credit control through higher discount rates had had a marked success. It was true that during the earlier period of its application, in the months of November and December, 1919, and January and February, 1920, an absolute check to the growth of rediscounting at federal reserve banks was not afforded. This fact, however, should be interpreted not in the light of absolute figures, but rather in that of relative conditions.

There was, in fact, during the months in question an absolute increase in the total amount of rediscounted paper held by federal reserve banks, but the real question at issue is not whether there was an absolute increase, but whether the increase which actually occurred would have been larger had it not been for the application of this method of credit control. On that point there would seem to be no doubt. The advance in the total of earning assets from about the beginning of March, a date roughly corresponding to the opening of the great growth in industrial and speculative operations throughout the country, to the beginning of November, at the time of the first application of the higher rate policy, amounted to the difference between \$2,348,000,000 on March 7 and \$2,923,000,000 on November 7, or about \$575,000,000 in round numbers. Between November 7, 1919, the date last cited, and the close of June, 1920, the increase of total earning assets from the point already mentioned was approximately \$260,000,000, the growth having thus been "slowed down" by over 50 per cent during a period of roughly the same duration. Later returns showed an even more positive effect as the result of credit

control and government operations, the total earning assets having declined from \$3,244,425,000 on May 28 to \$3,183,275,000 on June 25—a decrease of \$61,150,000

The success in thus controlling the growth of credit had been the more noteworthy because of the difficult conditions which had prevailed, chief among which had been the unsatisfactory transportation situation, which was in part the result of a lack of equipment on the part of the railroads and in part the consequence of the very severe weather of the late winter. These factors working together had the effect of compelling the retention of large quantities of goods at points of production or trans-shipment, with corresponding necessity of extending the length of the bank credit by which they were sustained, in addition to disorganizing distribution and market conditions at points of delivery.

CHAPTER LXIII

ON THE VERGE OF A PANIC

Discount Rates Unimportant

The conclusion of the year 1920 found the country at large practically on the verge of a panic. The situation is well worthy of careful note as exemplifying one of the stages through which federal reserve banking has passed. Nothing was more positively and loudly declared at the inauguration of the system than that the effect of its operation would be to prevent panic and to insure industrial stability. This statement was reiterated many times by politicians and by thoughtful publicists, the opinion evidently being that the credit expanding powers of the federal reserve system rendered it possible for that system to go as far as it chose in helping banks which were in a difficult position and in providing "emergency currency." These assertions were severely tested during the depression which had set in about mid-year of 1920, and as the year drew to its close there was an extraordinarily black outlook.

The discount rate advances of the system were of course planned for the reasonable restriction of credit. They had reached a maximum point of 7 per cent in the preceding June,¹ but had had no apparent influence on the situation as shown by the fact that credit continued to expand steadily up to the close of the year. All the symptoms of recession had manifested themselves, and in addition a tremendous crop of business failures had begun to be harvested. These were neither produced by the high discount rates nor prevented by them. Although in some districts the 7 per cent rate was fully up to or above the rate prevailing at member banks, it had no particular effect upon the situation, members continuing to discount

¹ This change was the outcome of the so called "deflation meeting" at the Treasury, May 18, 1920. See S. Doc. 310, 67th Congress, 4th Session, for minutes.

when needed, while the urgent character of the necessities of borrowers made them willing to pay any rate that circumstances seemed to dictate. Altogether, therefore, the federal reserve system, while at no time restricting the volume of its accommodation, save in isolated cases in some of the western districts, and save for an effort to reduce the excesses of speculation in the East, had done little or nothing to help or indeed to change the essential underlying conditions.

In previous panics or periods of stringency, difficulty had grown out of the fact that doubt arose concerning the ability of given institutions to meet their obligations, owing to the fact that their loans were frozen or that public confidence had resulted in withdrawing an undue amount of cash from them. On such occasions relief was obtained by the banks banding together for the purpose of supporting any of their number which had sound assets. In the depression of 1920-1921, the federal reserve system was in the position of a clearing house association, already organized in advance and able to assist the community, yet exerting no influence one way or the other upon the essential cause of the inflation or deflation of credit. As the difficulties of the business community moved steadily toward a critical point, the reserve system could and did do nothing to relieve them except to accommodate those banks which presented eligible paper. But the reserve system had of course no means of converting ineligible into eligible paper, or of strengthening banks which had been dishonestly or unwisely managed. Hence the development of many bank failures which the system had no means of correcting. The conditions amounted to a panic or business crisis without the capstone of financial suspension on the part of the solvent as well as of the insolvent banks of the country.

Bearing on Banking Theory

This condition of affairs had a deep bearing on banking theory which ought not to be neglected. Superficial thinkers

had in the years past likened the reserve banks to reservoirs of water which would be available to put out conflagration that might suddenly occur. The difficulty lay in the fact that fires when once started and under headway do not yield very readily to treatment of this sort. It is far better to have fireproof construction than to have even the most efficient fire department. The reserve system had been originally established with a view to the prevention of panics rather than their correction, in the thought that wise management would make it possible for such banks to check the undue expansion of credit. Experience had shown that the reserve banks had not the courage, nor the Board the power, to impose such a check against the wishes of the Treasury Department. In consequence, tremendous expansion had taken place and both banks and individuals had been allowed to get the use of credit far in excess of what was good for them or for the community. The reserve banks could not render much assistance by applying as a remedy a hair of the dog that had bitten, or, in other words, by merely pouring forth more credit into a community already waterlogged with past extensions of credit. It must therefore be concluded that the reserve system's only function in preventing panic or in correcting it lay in the fact that it afforded a ready-made organization of banking through which a conversion of assets into reserve funds might go on, and which effectually prevented any tendency to hoard cash. These services, indeed, were important in their way, but they were far from being those habitually rendered by central banks when at their best.

Elimination of "Frozen Credit"²

"Frozen credit" represented in a large measure the financing of products of various kinds carried over from a preceding year, or the obligations of individuals which had not been paid at maturity on account of the slow movement of goods into

²This and the following section was originally prepared by the author for Federal Reserve Bulletin, October 1921, p. 1151

the hands of purchasers. Increased activity in the cotton-raising states, resulting from advances in the price of cotton, eventually tended to bring about in some measure a clearance of the frozen credits which had been carried by banks in those districts. One effect of such liquidation was to reduce rediscounts with federal reserve banks. The outcome of this process is at times to make it appear that there has been a reduction in the total volume of credit extended, when, as a matter of fact, what had been done was to settle obligations made some time ago whose payment had no immediate bearing upon the financing of current business operations. Such elimination of frozen credit was not confined to the cotton-raising states, or indeed to the agricultural parts of the country in general, but the process of settling such indebtedness carried over from a preceding period was going on in many branches of wholesale and of retail trade as well, and in some manufacturing sections. The ultimate effect of it was to strengthen the banks by making their portfolios consist of self-liquidating accounts and by increasing the amount of their resources available for new production and business. Not the least important phase of the liquidation operation was that of enabling the banks to curtail their dependence upon the reserve institution for rediscounts. This reduced their expense of doing business and at the same time placed them in position to discount new and live paper which they could rediscount, inasmuch as they had reduced their earlier outstanding lines.

The situation was in some measure reflected in the increasing degree of self-support among the several districts, and their ability to supply their own credit demands without calling upon others.

Credit and Prices

In a low-price period a smaller amount of bank credit is required to carry a given volume of commodities than is the case when prices are high. In ordinary circumstances the varia-

tion of prices is not sufficient to make this an important factor in the study of credit. It should further be remembered that in ordinary circumstances variations in prices tend to react upon the volume of goods purchased, the amount turned out increasing as prices fall because of the increase in demand exerted by consumers. The year 1920 was one of those unusual periods in which a very great and continuous fall in prices has coincided with a large shrinkage in the out-turn of many kinds of goods, the result being to bring the influence of both factors—price reduction and product limitation—to bear upon the banks. Starting with May, 1920, when prices and the credit volume of the federal reserve system were both nearly at their peak, it will be noted that the growth of credit, after a recession during the summer, continued on to near the close of 1920, while prices, after a period of hesitation, fell, and this fall did not halt until the summer of 1921. The turn in the amount of outstanding accommodation made by the federal reserve banks, as measured by bills held, did not take a definite downward trend until December, 1920, at which time prices had already fallen about a third from the maximum. In a general way it may be said that there has been parallelism between the reduction of prices and the reduction in the amount of credit extended by the banks in general during the year 1920-1921, even though a decline in the volume of bills held by federal reserve banks continued after the fall of prices ceased and the slight upward turn in prices set in in July. The facts are illustrated in the following table which has been prepared for the purpose of making clear this situation.

The table shows considerable correspondence between shifts in credit accommodation and price changes. Expressed in percentages, however, it is evident, as stated above, that the decrease in credit accommodation has proceeded at a much slower pace than the drop in prices. The explanation of this lag in the contraction of banking credit as contrasted with price declines is primarily due to two facts—the first, that the volume

Date	Total loans, discounts, and investments (including bills rediscounted) of reporting member banks (000's omitted)	Month	Whole-sale price indexes in the United States (1913 = 100)
1920		1920	
May 14	\$16,983,816	May	264
June 11	16,926,277	June	258
July 16	16,893,150	July	250
Aug 13	16,828,278	August	234
Sept 17	17,057,374	September	226
Oct 15	17,283,996	October	208
Nov 12	16,848,730	November	190
Dec 17	16,803,226	December	173
1921		1921	
Jan 14	16,397,231	January	163
Feb 11	16,110,241	February	154
Mar 11	15,974,669	March	150
Apr 15	15,756,517	April	143
May 11	15,489,269	May	142
June 15	15,430,366	June	139
July 13	15,051,267	July	141
Aug 17	14,843,767	August	143

of bank accommodation cannot be instantly altered because the volume of bank paper, even on the most liquid basis, runs for a number of days, while at commercial banks the average life of paper would be still longer, the other factor in the situation is that in many cases a sharp fall in prices necessitates action on the part of banks in extending the credit which they have already granted to cover a rather longer period in order to give the borrower opportunity to readjust himself. Where such extensions are made there is necessarily a postponement of the date when the credit movement will adapt itself to that of prices.

Demand for Higher Prices

The fact that prices were receding and business following them, needed in the popular mind to be explained. The way of explaining it was found in a popular analysis of dis-

count rates and banking conditions from which was drawn the inference that the great source of trouble lay in financial changes that had occurred since the armistice. These outstanding changes were obviously to be sought in the reduction of advances made to foreign governments, in the higher discount rates of the federal reserve system, and in the general restriction of credit, or what was supposed to be such. It was perhaps not unnatural to assume that relief would be obtained and prosperous times restored by reintroducing the policies which thus had been weighed in the balance and found wanting and so discarded. There began, therefore, to be vigorous outcry in favor of a policy which would extensively aid foreign countries by floating in the United States their issues of securities.

During the latter part of the year 1920, agitation for the cancellation of foreign public debts had reached a high level and the propaganda work which was being done in the United States in favor of the floating of still larger issues of securities was very extensive. Various bills made their appearance in Congress with the purpose of appropriating enormous sums to aid this or that country, the real intention being of course to provide an artificial demand for American products and only uncertainly to afford relief to those who thus were supposed to need it. Secretary of the Treasury Houston found that foreign countries were planning debt cancellation campaigns and that they had obtained a singularly large amount of support in the United States. Steady resistance on his part to all such attempts was paralleled by persistent refusal in Congress to consider the extension of any more loans notwithstanding the constant efforts of foreign countries to obtain favorable consideration for their demands. The foreign situation, however, was considerably easier to handle, politically speaking, than the domestic. The idea had become deeply rooted in a great many minds that there was no reason why the federal reserve system should not extend almost un-

limited quantities of credit to those who desired it or could present security. In their opinion the only reason for withholding this credit was a difference of opinion as to whether further advance of prices was or was not desirable. On that point many business men had definitely accepted the conclusion that steady and continuous advance of prices, both for stocks and for goods, was urgently to be desired and indeed represented the only sound and consistent policy.

Demands of Business Men

These views were expressed not only by individuals, but also by organizations of business men who desire it was to obtain a reversal of the policy which the Board in their opinion had been following and which had resulted as they thought in price reductions. In memorials to the Board they pointed out the declines that had occurred in stock and bond quotations, the suffering that was being endured by business concerns which were losing money on accumulated supplies of commodities, and the unemployment that was being inflicted upon workers who were unable to find a demand for their services. All these things, it was asserted, would have been avoided had it not been for the disposition of the reserve system to restrict credit and so to prevent the continued development of prosperity throughout the country. In the interest, therefore, of every economic cause they were inclined to urge the restoration of larger extensions of credit, believing, as they did, that the inability to obtain them lay at the root of the troubles from which the community was suffering. These demands, however, were not needed, for Secretary Houston preserved his attitude of total indifference to them, absolutely refusing to be moved by the expressed dissatisfaction of the public. At a later date Governor Harding of the Federal Reserve Board reviewed the entire situation in a letter to Hon. Reed Smoot, in which he discussed the de-

velopment of credit during the years 1919-1920⁸ Some of the outstanding considerations which he then brought forward are so well worthy of consideration that they may be reproduced as follows

Owing to the exigencies of Treasury financing, the war-time Federal Reserve rate of 4 per cent was not advanced until November, 1919, although after the first of July, 1919, there was a rapid advance in the market rate for money and the best grades of commercial paper sold in the open market at from 7 per cent to 8 per cent. The customers of the member banks were willing to pay full rates for accommodation and urged upon the banks as a reason for easy credits that they were willing to pay high rates and the banks in turn could rediscount with the federal reserve banks at a very substantial profit. On or about September 15, 1919, the total amount of invested assets of the federal reserve banks, including bills rediscounted for member banks, acceptances bought in the open market, and Government obligations held, amounted to about \$2,350,000,000. An expansion of bank credits was going on all the time at a rate which has never been equaled in the history of the country and far in excess of any war-time expansion. Federal reserve bank rates were advanced to 4¾ per cent early in December, 1919, but the advance was negligible and had no effect. The latter part of January, 1920, rates were advanced to 6 per cent. On January 23, 1920, the total rediscounts and earning assets of the federal reserve banks amounted to about \$3,030,000,000, an increase since September 19, 1919, of \$680,000,000. The rate of expansion for that period was nearly 30 per cent. At the same time the reserves of the Federal reserve banks had declined to about \$2,090,000,000, of which only about \$2,030,000,000 were gold reserves. The pyramiding of credits was proceeding at an alarming degree and it was evident that if expansion should continue to proceed at such a rapid rate, it would be merely a question of time until the credit structure of the country would explode.

It should be noted that even after the rates were increased the expansion of loans and currency continued in a more moderate degree. On January 16, 1920, the total loans and earning assets of the federal reserve banks amounted to about \$3,000,000,000. These increased gradually and steadily until November 5, when they amounted to \$3,400,000,000. On January 16, 1920, the volume of federal reserve

⁸ Bulletin, August, 1921

notes outstanding was about \$2,800,000,000, and this note issue also increased steadily until it reached the peak on December 24, 1920, of \$3,400,000,000. You will remember that the great price reactions which took place all occurred before November 5 or December 24. Wholesale prices reached their peak about the middle of May, 1920, being at that time about 272 as against 100 for the year 1913. After the middle of May wholesale prices declined steadily, although the loans of the federal reserve banks and federal reserve note issues increased until November 5 and December 24, respectively.

Since the close of the year 1920 there has been a marked reduction in the loans and note issues of the federal reserve banks combined, although this reduction has been by no means uniform at all the banks. As a matter of fact, the liquidation in the New York district has been about equal to that in all other districts combined. The rediscounts and advances of the Federal Reserve Bank of New York, at the close of business on June 30, 1921, were lower than they had been since July 10, 1918. I would call your attention to the fact that on July 9, 1920, the Federal Reserve Bank of New York had total bills discounted and bought amounting to \$1,001,864,000, while on July 6, 1921, total bills held at the Federal Reserve Bank of New York were \$461,585,000, a reduction of \$540,279,000. If comparison should be made a week earlier in each case, it would be seen that a reduction took place of \$578,695,000. Bills held at the Federal Reserve Bank of New York increased from June 29, 1921, to July 6, 1921, from \$423,169,000 to \$461,585,000, a net increase for the week of \$38,416,000. The detail is as follows:

	July 9, 1920	July 6, 1921
Secured by United States bonds and certificates	\$ 544,229,000	\$212,999,000
Commercial paper, etc	303,454,000	236,970,000
Bills bought in open market	154,181,000	11,616,000
Total	\$1,001,864,000	\$461,585,000

The Federal Reserve Board has made no suggestion whatever that any federal reserve bank should undertake to force farmers to sell their cotton before the new crop comes in and telegraphic inquiry made of the federal reserve banks in the cotton-producing districts shows that no such restrictions have been made by the federal reserve banks . . .

In conclusion, I wish to say that the attitude of the Federal Reserve Board toward agriculture has been greatly misunderstood and grossly misrepresented. The Board has always advocated as liberal a policy as possible, consistent with the terms of the federal reserve act and with reasonable banking prudence toward agriculture which it recognizes as the basic industry of the country and the foundation upon which all other industries necessarily rest. The trouble is that the loans made by the member and nonmember banks throughout the country are not well distributed and in a number of cases have not been judiciously made. Something over a third of all member banks are not borrowing from the federal reserve banks at all, and of the two-thirds which are borrowing, more than one-half are borrowing very large amounts. Many of these banks have extended themselves so far that they do not feel warranted in making any new loans, regardless of the disposition of the federal reserve banks to rediscount the paper. They do not want their names on any more paper than they already have. They do not like the idea of increasing their contingent liability. In view of the fact that the twelve federal reserve banks are independent bodies corporate and are controlled and directed each by its own board of directors, subject only to the general supervision of the Federal Reserve Board, whose authority with respect to discount is confined principally to defining eligible paper in accordance with the terms of section 13 of the federal reserve act, it seems to me that the statement which many, both in Congress and on the outside, urge be issued by the Federal Reserve Board, stating that the federal reserve banks will adopt certain policies in connection with the rediscounting of agricultural paper, would have to be made by the federal reserve banks themselves. The Federal Reserve Board has no power to interfere with the discretion given or the responsibility imposed by law upon the directors of a federal reserve bank with respect to passing upon the merits of eligible paper offered for discount.

By way of summary, let me state that while the federal reserve act imposes a general limitation upon the maturity of paper eligible for discount of three months, it is provided in section 13 "that notes, drafts, and bills drawn or issued for agricultural purposes or based on live stock and having a maturity not exceeding six months, exclusive of days of grace, may be discounted in an amount to be limited to a percentage of the assets of the federal reserve bank, to be ascertained and fixed by the Federal Reserve Board." Had the Board been unfriendly to agriculture, as many of its critics claim it has been, it could easily have limited the amount of six months' agricultural paper

which could be discounted by a federal reserve bank to a very small percentage of its total assets. But in order to offer the fullest possible accommodations to agriculture, the Board more than five years ago fixed this percentage at 99 per cent and has never changed it. It has already been pointed out that the decrease of more than \$1,100,000,000 which has taken place in the loans and earning assets of the federal reserve banks is represented mainly by a reduction in loans secured by Government obligations and by bills and acceptances bought in the open market. The actual reduction in commercial, agricultural, and live-stock paper, rediscounted for member banks, from July 9, 1920, to July 6, 1921, was \$138,257,000. This reduction is more than accounted for by the decrease of paper rediscounted by federal reserve banks in Boston, New York, and Chicago. The bank liquidation which has taken place has been mainly in financial and industrial centers, and the figures of the federal reserve banks do not indicate that there has during the past 12 months been any decrease in federal reserve accommodations to banks in the agricultural and live-stock districts, but on the contrary there has been a considerable increase, as you will see from the official statements inclosed herewith.

Very truly yours,

W. P. G. HARDING,
Governor

Hon. REED SMOOT,
United States Senate

The System in Politics

Receiving no encouragement from either the Treasury or the Federal Reserve Board, it was natural that those who felt dissatisfied should turn to the politicians for assistance. The presidential campaign of 1920 started comparatively early in the year and at first seemed unlikely to involve much discussion of currency or banking. There was a kind of common consent among politicians to the effect that the banking outlook should not be dragged into a situation which did not call for or warrant any such treatment, but that so far as practicable the contest should be waged without making reference to it. This attitude, however, was maintained only for a short time and it was not long before orators on both sides were making charges against the reserve system to the effect

that it had restricted credit, had rendered recovery difficult for the farmer, and had otherwise damaged the organization of business. The Democratic nominee once or twice wrote to Governor Harding with queries regarding reserve bank policies and with recommendations of lower rates, giving his correspondence, of course, to the press. Republican orators, on the other hand, attacked the system more or less openly, promised relief from high rates if elected, and otherwise held out to the voter the notion that the government could and should in some way interpose to rectify conditions of shortened credit, or to reduce interest and discount rates in order to supply current necessity.

Accordingly, the campaign of 1920, before it was half over, had begun to involve a rather large element of discussion of finance, banking, and currency, and more or less explicit promises had been made with respect to help for the farmer, lower rates, and general changes in conditions. The election of President Harding and a Congress overwhelmingly in sympathy with him left the short session of 1920-1921 as little more than a period for clearing up the unfinished business which still held over while awaiting the advent of a new régime. The reserve system had definitely been brought into politics even more than had been true during its inception and previous history, and politicians had now given pledges regarding their banking policy in a way never before resorted to.

Panic Avoided

The measures of contraction which had been set at work and which were thus persevering, regardless of public opinion, were, however, producing their results during the latter part of the year 1920. With the close of that year, reserve bank portfolios began to decline. Prices had already sharply fallen. There had been a tremendous mortality of business enterprises, our foreign trade had been largely cut back, and condi-

tions were in a much more favorable state. As has been seen on former occasions, little if any of this work was attributable to positive policies of the federal reserve system, but the system at least refrained from making matters worse by relaxing credit still further, while at the same time it persevered with the assistance and countenance of the Treasury Department in pushing government bond-secured paper out of reserve banks. This primarily was the great contribution of the reserve system to the process of reorganization. A panic had been definitely avoided, although the business of the country had passed through many of the same experiences and had suffered from many of the losses that had been common on past occasions of the same sort.

The lesson of the year 1919-1920 had become emphatically clear. It was that neither the expansion of credit nor the unlimited supply of credit at the peak of expansion could help business, but that both restriction and control on the one hand, and stimulus on the other, must be applied in the very early stages of inflation and deflation movements. For such work the federal reserve system was not being used, as clearly appeared from its primarily emergency development. Its failure to enter the open market or the foreign field had prevented it from employing the usual methods of central bank control, and its tentative and slow application of discount rate changes in the domestic field had been without result. In these circumstances it was apparent that panics might be expected to recur in the future just as in the past, the influence of the reserve system being perhaps that of accelerating or retarding the process but little more than that.

CHAPTER LXIV

THE FEDERAL RESERVE SYSTEM UNDER FIRE

National Scapegoat

Reaction in business and difficulty in maintaining even a reasonable degree of solvency in many lines of trade are conditions which have always in the past led to the search for a national scapegoat. Such a scapegoat has too often been found in the banking and financial community which, although it has had its own sins to answer for, cannot be reasonably regarded as a universal offender. It had been supposed that the great service of the reserve system during the war and its conspicuous success in preventing panic, even under circumstances of great difficulty, might in a sense have preserved it from the usual attack which in past times of depression has come to our banking system. This, however, was not to be. In reviewing the later post-war years of the federal reserve system, more attention perhaps should be given to politics and to administration than to economics. Certainly the three classes of considerations must be combined in order to gain even a reasonable analysis of the situation.

Earnings of Reserve Banks

In looking over the field from this point of view and with a view to understanding the present position of the reserve system, attention must undoubtedly be paid to certain elements in its history which, however insignificant from the economic standpoint, have a large political bearing. Of these perhaps the most significant is the question of reserve bank earnings. It will be remembered that in the Federal Reserve Act dividends to stockholders had been limited to 6 per cent, the whole

remainder above that figure to go to the government as a "franchise tax" after an allowance of 40 per cent to surplus. In European countries it has ordinarily been customary to fix the franchise tax and to leave the bank to make what it could by way of earnings for stockholders over and above that figure. But in framing the Federal Reserve Act, it was thought wise to avoid, if possible, the imputation that the monopoly power of note issue was being used by banks, the act therefore giving them only a moderate commercial return on their money.

During the first year or two of the reserve banking system, it had seemed likely that the institutions would not be able to do more than pay expenses. One or two of them had paid dividends to stockholders, but had succeeded in doing so only by counting every possible source of enhancement in value of assets, by spreading out their organization expense over a considerable period, and by otherwise giving themselves the advantage of all doubts. As has been seen at an earlier point, it had been seriously argued by members of the Federal Reserve Board that the reserve banks if "properly run" could never pay dividends, and an effort had been made to return their capital stock to the member banks. This effort had been frustrated, and it had been determined to go on as originally intended under the act with a moderate paid-up capital. The war, however, had suddenly and entirely changed the whole situation by giving the reserve banks enormous volumes of business which, although taken at extremely low rates, were nevertheless so great in amount as to give them what appeared to be immense earnings. These earnings were far greater in proportion to capital than would normally have been the case in any ordinary bank, for the reason that the capital of reserve banks was, after all, only a very small fraction of their resources, so that, when stated in percentages, it seemed as if abnormal returns were being made. Had the percentages been computed on the basis of total resources, including de-

posited reserves, an entirely different impression would then have been made

Congressional Attitude

All this was, of course, not recognized by Congress, or if recognized was ignored. Congress and the political campaign committees had already been inclined to attack the reserve system during its lean years of organization as nothing more than a means of providing some good places for political favorites. True, it had been difficult to find any cases of favoritism or nepotism, but the charge had nevertheless been made and repeated from time to time as opportunity afforded. Congress is a body which has never been noted for its consistency, and accordingly it was not strange when reserve banks began to show large earnings as the result of the war, that they should be brought violently under attack on the ground that they were grinding the faces of the poor by their exorbitant charges.

The earning of reserve banks may be conveniently surveyed at this point in the following table

NET EARNINGS OF FEDERAL RESERVE BANKS

1914	.	1919	\$82,038,785
1915		1920	82,087,000
1916	\$ 2,751,000	1921	86,798,000
1917	11,202,993	1922	20,931,000
1918	55,446,979		

Out of these earnings, funds transferred to the government of the United States were as follows ¹

During the year 1921 the federal reserve banks had set up a reserve for franchise tax, the total of which was on October 27, 1921, \$53,938,000 (weekly statement federal reserve banks combined, October 27, 1921). This tax reserve was adjusted weekly and the total amount shown to be due the government at the close of business December 31, 1921, was ordered paid to the Treasury on January 3, 1922.

¹ S. Doc. 75, 67th Congress, 1st Session

FRANCHISE TAXES PAID TO THE UNITED STATES GOVERNMENT

Federal reserve bank	1917	1919	1920	Total*
Boston	\$ 75,000		\$ 2,473,499	\$ 2,548,599
New York	649,363	\$2,703,894	39,318,511	42,671,768
Philadelphia			363,662	363,662
Richmond	116,472		204,585	321,057
Atlanta	40,000		2,136,288	2,176,288
Chicago	215,799		10,394,480	10,610,279
Minneapolis	37,500		524,234	561,734
Kansas City			2,240,228	2,240,228
San Francisco			3,069,255	3,069,255
Total	\$1,134,234	\$2,703,894	\$60,724,742	\$64,562,870

* Totals transferred for 1921 and 1922 were \$59,974,406 and \$10,850,604, respectively

Political Intrigue

As the tables indicate, the close of the war financing period, although not contemporaneous with the close of the war, was not long deferred, yet it was postponed for a sufficient time to furnish a basis for political intrigue and attack along the lines just indicated. True, an immense surplus of earnings had been paid to the government, as indicated in the foregoing table, so that the government had primarily profited by the war financing, in so far as reserve banks were concerned, while the member banks, as already often noted, had for the most part discounted for their customers during the war period without profit, simply giving to borrowers the same rate that was charged at reserve banks—approximately the coupon rate on Liberty bonds and notes. It is difficult to say how the reserve system could have resisted this type of attack. It was first abused for its lack of earnings, then for its high earnings. It was obnoxious because of its inability to support itself, then because of the fact that it was drawing so heavily upon the resources of the community. True, it could not be charged with having made great monopoly profits, because the bulk of its profits went to the government, nevertheless the earnings situation was undoubtedly an occasion for the casting of en-

vious eyes at reserve banks and for stirring up political hatred among the rank and file of voters by the citation of immense figures, not of dividends paid, but of "earnings" received

Salary Policy of the Reserve Banks

At an earlier point it has been noted how Secretary McAdoo, in order to reward officers of reserve banks who had done yeoman service during the war, had sustained a "drive" for higher salaries² which had set in about the time of the

² The facts as to this were partly made public by Governor Harding, who in a letter written to Hon. Sydney Anderson in 1921, quoted from the minutes of the Board as follows:

In December, 1918, the directors of the Federal Reserve Bank of New York again voted to increase the salary of Gov. Strong to \$50,000 per annum. The following is an extract from the minutes of the meeting of the Federal Reserve Board on December 14, 1918:

"Present The chairman (Mr. McAdoo), the governor, Mr. Strauss, Mr. Miller, Mr. Hamlin, Mr. Williams, Mr. Broderick, secretary

"Mr. Strauss stated that he had reviewed the recommendations of the Federal Reserve Bank of New York of increases in salaries of and bonuses to its officers and employees, and submitted the following report, which was ordered spread upon the minutes of the meeting:

(Here follows report of Mr. Strauss on a letter from Mr. George F. Peabody, deputy chairman of the board of directors of the Federal Reserve Bank of New York, on the subject of increased compensation for employees of the bank.)

"The chairman expressed himself as heartily in accord with the principles propounded by Mr. Strauss. He then explained to the Board his views as to the principles that should be observed in determining compensation to officers of Federal reserve banks. He stated that his attitude had been that in the beginning and during the formative period of the system he advocated comparatively low salaries until the business of the banks could be established, and a fair measure obtained of their operations and a more accurate realization reached of the dimensions of the problems and responsibility of the banks' officers, adding that last year he had opposed an increase in the salary of the governor of the Federal Reserve Bank of New York only because the country was at war. He said, now that the business of the banks had been well established and they were making large earnings for the Government, the time had come when the office of governor of a Federal reserve bank should command on its merits a fair and just compensation, and that he would vote to fix the salary of the governor of the Federal Reserve Bank of New York at \$50,000 per annum, this salary to prevail not only for the present incumbent, but for his successors. The chairman stated it as his view that the principle governing the fixing of salaries of officers of Federal reserve banks should be that the salary be made sufficiently attractive to make a man willing to adopt the Federal reserve system as a permanent career having its rewards in the way of promotion like any other institution. He opposed the view that the office of head of a Federal reserve bank should be considered on a parity with high Government office, stating that heads of Federal reserve banks could not be said to enjoy that magnitude of power and prestige pertaining to high Government office, while the bank officers were yet placed in a different position from those engaged in private institutions in that they were affected by the mutations of public life and controlled by a changing public board.

"The chairman stated that he had conferred with the Secretary of the Treasury-elect, Mr. Carter Glass, who concurred in the substance of the principles recited by him, leaving it to the Board, of course, to make, under such principles, reasonable adjustments of salaries throughout the system in its discretion.

"The chairman stated as a further principle that the salary of a Federal reserve agent should be at least as high as that of any deputy governor of the Federal reserve bank of which such agent may be chairman.

"Mr. Miller pointed out that the tremendous earnings of the Federal reserve banks had accrued this year largely out of Government business, and asked the chairman if he had that factor in mind in expressing his opinion on the question.

"The chairman replied that he did not think the percentage basis of earnings of banks is a fair guide for the measure of compensation to be paid, stating it as his judgment that the questions of salaries at the several banks should be dealt with each on

armistice The result had been to establish a high scale of salaries which, as soon as it became known, paved the way for another congressional onslaught and gave point to the criticism of the earnings situation At the beginning of the organization the Board had felt grave doubt concerning its salary policy It had found it necessary to have competent men at the reserve banks, but it hardly felt warranted in paying to these men the full commercial salary attaching to a similarly important post in the commercial world The salaries of reserve officers were placed on a level rather distinctly below that prevailing in the commercial communities in which they were situated On this basis there had been some loss of efficient officers during the early years of the system, and when the war activities were at their height the Board was undoubtedly influenced by the desire to avoid loss of men at a time when continuity and efficiency were urgently necessary

So the Board had itself been somewhat inclined to yield to the high salary argument which was steadily put forward by the complaisant directors of reserve banks in behalf of their officers, and had practically allowed itself to be weaned

its own merits with respect to the responsibility assumed by the governor when taking office

"Mr Strauss stated that the board should not consider the earnings of a bank in fixing compensation, that at future periods it might well be the business of the banks not to make money

"The chairman concurred in this view, stating that it might be necessary to operate a bank at a loss as a result of a general plan of combining the resources of all banks as a common fund, in which event the responsibilities of the governor of a bank forced to operate at a loss would be even greater than when large earnings were accruing He said the problem was to ascertain what is a just compensation, taking into consideration all the elements of the problem—the size of the bank the cost of living in the community, and the responsibility assumed by the chief executive officer of the bank

"Mr Williams pointed out that there were certain governors of Federal reserve banks whom the board felt were not the strongest men for their positions

"The chairman stated that if the Board undertook the responsibility of keeping in office incompetent men as governors of Federal reserve banks the salaries of such governors should nevertheless have a relation to the responsibility assumed

"On motion, duly seconded, it was voted unanimously that the salary of the governor of the Federal Reserve Bank of New York for the ensuing year be approved if fixed at \$50,000 per annum and that the recommendations of the Board of Directors of the Federal Reserve Bank of New York as submitted by Deputy Chairman Peabody in his letter of December 11, 1918, as modified in principles by the memorandum submitted by Mr Strauss, above, be approved with the understanding that the Board will review same in detail and make such adjustments as may be necessary at its meeting on Monday, December 16

"At this point the chairman (Mr McAdoo) stated that it was necessary for him to withdraw from this, the last meeting of the Federal Reserve Board which he would attend, and expressed to the members of the Board his appreciation of the work they had done during his incumbency of the office of chairman, stating that he would always have a keen interest in the personal welfare of members of the Board, as well as in their official work."

from the earlier ideal of public service in reserve banks corresponding to the standards which existed in European central banking institutions. It had, in effect, gone over to the conception of American banking—a highly paid and undoubtedly efficient body of officers supported by a low-paid and factory-organized body of clerical employees. Whether it could have avoided such a change and have constituted a new and better régime in its handling of the personnel question, may be doubtful. The fact is that the Reserve Act had definitely committed this question to the local boards of directors, who were themselves bankers and business men and who were immediately responsible to their stockholders—the member banks of the district. It was not a matter for which the Board had immediate responsibility, although the act gave it the right to veto undesirable salaries or expenses whenever it saw fit and without the assignments of reasons for its action. This of course was for the purpose of preventing the reserve banks from paying out unduly large parts of their entire earnings in the form of salaries, and so preventing the government from getting an adequate return through surplus earnings.

Earnings versus Salaries

It is interesting psychologically to the student of general business conditions to note how the fact that the reserve banks were making very large earnings tended to react upon the salaries which were demanded of them, notwithstanding there was of course no relationship between the two—certainly none after the time had come when the banks were supporting themselves and were paying their 6 per cent dividend. But as often happens in such cases, the fact that large earnings were mechanically being made by the banks as the result of war was constantly cited as an example of the skill and economy with which they were being operated or even more frequently as evidence of the enormous responsibility resting upon those who

had been entrusted with the management of reserve bank affairs. Altogether, therefore, it was clear from the time that war earnings had begun to accumulate, that a drive for high salaries would be practically irresistible.

The idea of public service in the reserve banks had not acquired any stronger hold during the first three or four years of the system's history than it had at the outset, and the inevitable consequence of this condition of affairs was to make reserve bank officers feel that they were not only entitled to the money but that the time had come when they could take it without infringing upon anyone's rights, even those of the government. Accordingly from the beginning of 1918 onward, the salary issue became intensely acute, and, as already seen, the Board was practically compelled to yield, for it should be added, there had never been a time, even from the beginning, when the Board as a whole was inclined to a niggardly or mean attitude in the matter, or indeed any more than what might be considered a reasonable degree of conservatism. As war operations expanded, as the number of persons employed grew by leaps and bounds, eventually reaching 12,000 or more, and as a vast building program was developed, the outcome became practically a foregone conclusion. Criticism did not develop in Congress for some time, for the reason that Congress was concerned with other matters, paying but little attention to the internal technique of reserve banking and for the time being was more or less friendly, politically speaking. After the close of the war, when the deflation era had set in and when search began to be made for grounds of complaint, the salary situation at the reserve banks naturally began to receive consideration. Eventually information was called for by the Senate with reference to the salaries actually paid, and a complete reply on the subject was submitted by Governor Harding in a document which gave all details of officers' salaries. The main facts thus revealed may properly

be furnished at this point without awaiting their chronological sequence, as follows ⁸

AVERAGE ANNUAL SALARIES PAID TO OFFICERS BY EACH FEDERAL RESERVE BANK AND BY THREE OF THE LARGER MEMBER BANKS IN EACH FEDERAL RESERVE BANK CITY, AS OF OCTOBER, 1921
(Bonus excluded)

Federal reserve district	Federal reserve bank	Member bank
Boston	\$ 9,679	\$14,745
New York	12,745	*17,331
Philadelphia	10,125	15,733
Cleveland	7,792	10,061
Richmond	6,696	6,473
Atlanta	5,677	7,828
Chicago	7,946	15,440
St. Louis	7,078	11,675
Minneapolis	6,478	10,621
Kansas City	6,147	10,313
Dallas	5,512	8,767
San Francisco	6,459	11,409
System	\$7,743	\$13,092

* Six national banks

It will be seen from this table that the average salary of officers in all federal reserve banks is \$7,743, while the average salary paid by the larger member banks in federal reserve bank cities is \$13,092, or 69 per cent in excess of that paid by the federal reserve banks.

With reference to the statement frequently made that salaries paid by the Federal Reserve Bank of New York increased 50 per cent between the years 1918 and 1920, while at the same time the number of officers and employees increased only 10 per cent, the board would state that during this period the total salaries of officers and employees increased by \$1,534,443, of which amount \$1,336,443 represented the increase in salaries paid to employees and only \$198,000 the increase in salaries paid to officers. In explanation of the higher aggregate salaries paid to employees of the Federal Reserve Bank of New York, which increased 47 per cent during the two years as compared with an increase in number of only 10 per cent, there is given below a table showing the average annual salary paid to employees by that bank,

⁸ S. Doc. 75, 67th Congress, 1st session, p. 13

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as of the last day of December of each year from 1915 to 1920, both inclusive, and as of July 1, 1921, as well as by each other federal reserve bank

AVERAGE SALARIES PAYABLE TO EMPLOYEES OF EACH FEDERAL RESERVE BANK (INCLUDING BRANCHES)
(Bonus excluded)

Bank	Dec 31						July 1, 1921
	1915	1916	1917	1918	1919	1920	
Boston	\$1,086	\$ 985	\$ 991	\$ 929	\$1,184	\$1,271	\$1 401
New York	1 152	934	1,003	1,095	1,206	1,456	1 471
Philadelphia	1,000	838	796	983	1,133	1,258	1,266
Cleveland	1,242	883	1,020	1,183	1,206	1,360	1 383
Richmond	1,044	691	794	996	1,030	1,190	1 233
Atlanta	1,005	869	1,053	998	1,054	1,149	1,281
Chicago	1 142	949	1,120	1 094	1,115	1,310	1,408
St. Louis	1,068	986	953	1,028	1,051	1 214	1,326
Minneapolis	1,289	881	942	646	1,091	1,262	1,288
Kansas City	936	961	1,003	1 024	1,194	1,209	1,442
Dallas	1 382	1,017	919	1,110	1 168	1 270	1,447
San Francisco	1,496	925	1,144	1,227	1,268	1 366	1,521
System	\$1 128	\$ 912	\$1,004	\$1,062	\$1,163	\$1,319	\$1 402

It will be observed that the average salary paid to employees by the federal reserve banks was very low in 1918, being practically on a level with salaries paid bank employees prior to the war, when prices were about one-half of what they were in 1919 and 1920, when the increase in the average salary paid to employees took place

An investigation made by the Federal Reserve Bank of New York in 1919 showed that the average annual salary, including bonus, paid to employees by the bank was \$1,440, while the average annual salary, including bonus, paid to employees by 10 of the large New York City banks ranged from \$1,620 to \$2,265. In fact, it was found that in 6 of the banks the average salary paid employees was in excess of \$2,100. It was represented to the Board that if the Federal Reserve Bank of New York was to retain its employees it would have to increase salaries to a level more nearly approaching salaries paid for similar work by other banks in New York City. The fact that the average salary paid employees by the federal reserve bank at the end of 1918 was only \$1,095, when the cost of living index as published by the Bureau of Labor Statistics of the Department of Labor was 77 per cent above the pre-war level, gradually increasing to 119 per cent in December, 1920, would seem to justify the increase in salaries granted employees during the years 1919 and 1920.

In order that the Senate may be informed as to whether the number of officers of federal reserve banks has increased relatively more than the number of employees, and whether the number and salaries of officers and employees of the federal reserve banks have increased more rapidly than the volume of business and routine operations of those banks, the following table is submitted showing the changes in personnel and salaries, the growth in the principal items of assets and liabilities of the banks, and the increase in the volume of their operations by years from 1915 to 1920

INDEX OF GROWTH, 1915-1920, IN NUMBER AND SALARIES OF OFFICERS AND EMPLOYEES, AND IN BUSINESS TRANSACTED, FOR EACH

FEDERAL RESERVE BANK
(1915=1)

Federal reserve bank	Officers		Officers and employees		Assets and liabilities		Volume of discount and open market operations	Transactions through gold settlement fund
	Number	Salaries	Number	Salaries	Earning assets	Federal reserve notes in circulation		
Boston	3	4	39	21	20	31	225	37
New York	5	5	40	29	95	12	989	88
Philadelphia	3	3	19	15	35	32	281	38
Cleveland	5	4	31	21	39	33	244	238
Richmond	5	5	22	16	17	10	77	60
Atlanta	4	4	11	9	18	10	66	41
Chicago	9	5	35	25	47	203	281	45
St. Louis	5	3	22	14	42	17	224	36
Minneapolis	3	3	23	13	23	6	107	111
Kansas City	7	5	22	20	21	11	113	70
Dallas	5	4	20	13	14	5	53	63
San Francisco	8	5	51	26	93	53	263	74
System	5	4	28	20	39	18	314	50

Underpaid Employees

Along with this showing made by Governor Harding at the request of the Senate should be classed an investigation which was carried on by the Division of Analysis and Research of the Board for the purpose of ascertaining how the employees of the several banks were paid. The inquiry originated in the desire to ascertain whether a system of bonuses designed to give them a living wage adapted to changes in prices was warranted and, if so, what amount of bonus was probably fair. The investigation, therefore, was directed not only to ascertaining

average wages, but also of cost of living, the number of persons depending upon the employees for support, savings, and other features whose general character was of a nature to throw light upon the question of wages from the subsistence standpoint. This inquiry showed that the employees of reserve banks were for the most part underpaid even as compared with the rank and file of bank employees, the reason being that reserve banking was necessarily more routine and less individualized than ordinary banking, the operations being repeated over and over again on a factory basis by a large corps of relatively untrained employees. The Board, however, deemed it best not to give the full results of the investigation to the public, but eventually authorized the publication of certain principal items of information in the Federal Reserve Bulletin, from which the following summary is taken.

A questionnaire was prepared and distributed to all employees of federal reserve banks receiving salaries of less than \$5,000 per annum, requesting certain information relative to expenditures for the calendar year 1919. The questionnaire was divided into two sections, one to

Federal Reserve district	Families	Individuals				Total
		Not living at home		Living at home		
		Males	Females	Males	Females	
1	115	11	11	86	149	372
2	819	51	71	401	806	2,148
3	79	7	11	33	48	178
4	144	24	27	97	172	464
5	59	11	41	60	124	295
6	57	22	20	32	41	172
7	227	20	38	66	105	156
8	100	22	30	45	76	273
9	40	17	19	31	57	164
10	70	17	31	32	40	190
11	97	45	21	35	22	220
12	94	12	26	16	40	188
Total	1,901	259	346	934	1,680	5,120

be filled in by married individuals, heads of families, and all others who for one reason or another could best give the expenditures of a family group rather than their own individual expenditures, the other to be used by those giving their own individual expenditures. Allowing for the discard of faulty schedules, the above are the total number of schedules which were found usable.

The following figures for the Federal Reserve Bank of New York show the general character of the data, and are representative of the results obtained.

We may thus sum up the general situation as to salaries at reserve banks by saying that whereas those of officers were not higher on the average than those of the large banks in their respective communities, the salaries of employees were on about the same scale or perhaps slightly lower than other employees in the respective cities. This merely amounts to saying that the reserve banking system had assimilated itself practically to the conditions existing in American banking generally and on the whole was not more generous or more niggardly than the rank and file of large banks. It undoubtedly overpaid

ANALYSIS OF RETURN ON QUESTIONNAIRE RELATIVE TO EXPENDITURES
DURING CALENDAR YEAR 1919 OF EMPLOYEES OF THE
FEDERAL RESERVE BANK OF NEW YORK

SECTION I—FAMILIES

Salary group	Number of cases	Total expenditures, average amount
\$600 and under \$900	7	\$1,101
\$900 and under \$1,200	26	1,577
\$1,200 and under \$1,500	68	1,824
\$1,500 and under \$1,800	95	1,936
\$1,800 and under \$2,100	166	2,183
\$2,100 and under \$2,400	182	2,437
\$2,400 and under \$2,700	99	2,584
\$2,700 and under \$3,000	57	3,021
\$3,000 and under \$3,300	49	3,150
\$3,300 and under \$3,600	20	3,311
\$3,600 and under \$3,900	18	3,532
\$3,900 and over	32	4,336

SECTION II—INDIVIDUALS

A—Returns of those who, for the major portion of the year, did not live with immediate family or nearest relatives

Salary group	Number of cases	Total expenditures, average amount
Male		
Under \$600	5	\$1,606
\$600 and under \$900	3	770
\$900 and under \$1,200	7	1,173
\$1,200 and under \$1,500	10	1,478
\$1,500 and under \$1,800	7	1,564
\$1,800 and under \$2,100	5	1,846
\$2,100 and under \$2,400	6	1,919
\$2,400 and over	8	2,866
Female		
Under \$600	1	1,765
\$600 and under \$900	4	1,108
\$900 and under \$1,200	35	1,191
\$1,200 and under \$1,500	14	1,419
\$1,500 and under \$1,800	9	1,468
\$1,800 and under \$2,100	5	1,654
\$2,100 and under \$2,400	2	1,835
\$2,400 and over	1	2,045

some of its officers, as did the larger member banks, and it had not the excuse of the latter that the officers were "business getters," since in the reserve banks they had no business-getting function. Yet, when all was said and done, it must be admitted that the reserve banks were being conducted about as economically per unit as other banking institutions in the United States.

The Building Program

Another outgrowth of war conditions and of the high earnings which resulted from them was the elaborate building program of the federal reserve banks. No part of the expenditures of reserve banks has been the target of so much abuse and complaint as this, and yet there was nothing which in the main warranted any such criticism. In years past, as will be remembered, the United States government had erected sub-

B—Returns of those who, for the major portion of the year, lived with immediate family or nearest relative

Salary group	Number of cases	Total expenditures, average amount
MALES		
Under \$600	16	\$1,053
\$600 and under \$900	54	1,085
\$900 and under \$1,200	130	1,159
\$1,200 and under \$1,500	79	1,407
\$1,500 and under \$1,800	61	1,585
\$1,800 and under \$2,100	33	1,891
\$2,100 and under \$2,400	19	1,980
\$2,400 and over	9	2,414
FEMALES		
Under \$600	19	892
\$600 and under \$900	94	1,019
\$900 and under \$1,200	477	1,171
\$1,200 and under \$1,500	170	1,368
\$1,500 and under \$1,800	34	1,584
\$1,800 and under \$2,100	7	1,694
\$2,100 and under \$2,400	3	1,794
\$2,400 and over	2	1,836

treasuries at nine points throughout the country. These sub-treasuries had become old and obsolete, unfit even for the duties which they retained. It was evident from the opening of the war that the sub-treasuries must disappear, and as a matter of fact the whole system was speedily wiped out, as already set forth. The functions of the sub-treasuries were in chiefest measure transferred to reserve banks. The latter, meanwhile, had from the beginning of their career been housed in rented quarters. Yet the machinery of the modern bank is so complex and its requirements so special that it is felt necessary by commercial banks to build their own quarters, or at all events to secure very extensive remodeling of older buildings, in order that they may have at once a satisfactory access to the public as well as convenient and safe vaults and a well-lighted and properly arranged series of rooms for occupancy by the staff. In some cities the reserve banks were successful in obtaining

quarters which complied with these requirements, either because new buildings already under construction were partially remodeled to suit them, or because they obtained banking quarters which had already been vacated by other institutions, but in the main they were not so fortunate, and in a majority of cases they found their hired quarters cramped and inadequate even from a date soon after their opening

It is not likely that this inadequacy of accommodation would at any early date have resulted in the adoption of a building program had it not been for two facts the taking over of extensive Treasury functions, and the fact that the war provided them with the money to build in a way deemed suitable to their needs. The two things taken together provided both the excuse and the resources for constructing the palatial type of accommodation which the American banking mind has grown to associate with success or with soundness in financial management. Sporadic discussion of banking quarters, rentals, and construction had begun even before the opening of the war, and in one or two cases reserve banks were fully planned and well under way. The enormous expansion of personnel and the belief apparently entertained by many minds that the war might last a great while, added to the other considerations already enumerated, brought about the determination on the part of the Board to assent to a building program widely and positively urged by the governors of the reserve banks and by their boards of directors, and accordingly the services of architects who usually harmonized or unified the system of buildings were engaged and preparations were sanctioned for the undertaking of a vast series of building projects. In the aggregate, these projects, when completed, promised to cost \$60,000,000

No such great series of buildings could be undertaken, of course, without attracting the attention of the local public, and particularly of the politicians, or without arousing heartburnings in connection with the letting of contracts as well as jeal-

ousy among existing banks. Thus the foundation was laid for another type of congressional attack which developed simultaneously with the salary discussion and was fomented after the close of the Wilson administration by the efforts of ex-office holders to establish the belief that there had been irregularity or extreme extravagance in the letting of contracts and the drafting of plans. Congress eventually called for the facts in the case, although the main elements had already been made public in the Board's various annual reports. The reply furnished by Governor Harding may be summarized somewhat as follows ⁴

COST OF BANK PREMISES OF FEDERAL RESERVE BANKS, TO SEPTEMBER 30, 1921
(Figures include cost at head office and branches)

Federal reserve banks	Original investment	Cost of remodeling bank buildings	Cost of new buildings in course of construction	Total cost to Sept 30, 1921	Depreciation allowances charged off	Book value Sept 30, 1921
Boston	*\$1,296,380		\$ 3,160,183	\$ 4,456,563	\$ 200,000	\$ 4,256,563
New York						
Banking house	4,797,882		758,072	5,555,954	1,841,618	3,714,336
Annex building	681,531		1,528,925	2,210,456	147,801	2,062,565
Philadelphia	600,000	\$1,099,638		1,699,638	1,166,848	532,790
Cleveland	1,806,235	406,150	1,197,872	3,410,257	384,235	3,026,022
Richmond	659,922		2,103,014	2,762,936	228,434	2,534,502
Atlanta	*568,750		505,743	1,074,493	213,248	861,245
Chicago	2,936,149		2,900,535	5,836,684	849,062	4,987,622
St. Louis	*1,311,197	560		1,311,757	685,000	626,757
Minneapolis	615,000		252,886	867,886	177,738	690,148
Kansas City	730,000	32,974	2,791,827	3,554,801	100,000	3,454,801
Dallas	399,749	39,240	1,775,180	2,214,175	159,344	2,054,831
San Francisco	520,785	232,895	448,776	1,202,456	530,795	671,661
Total	\$16,923,580	\$1,811,463	\$17,423,013	\$36,158,056	\$6,684,213	\$29,473,843

*Net

In reviewing the building program of the reserve banks, no positive or dogmatic conclusion can be arrived at. The expediency or desirability of any such program depends entirely on what is believed to be the future of reserve banking in the United States. Considering the fact that the reserve banks had already taken over the extensive Treasury functions already referred to, it is, however, easier to say that the investments made in the buildings may turn out to be a wise anticipation.

⁴ S. Doc. 75, 67th Congress, 1st Session, p. 21

COST OF BANK PREMISES OF BRANCHES OF FEDERAL RESERVE BANKS,
TO SEPTEMBER 30, 1921

Branches	Original investment	Cost of remodeling bank buildings	Cost of new buildings in course of construction	Total cost to Sept 30, 1921	Depreciation allowances charged off	Book value Sept 30, 1921
Buffalo	None					
Cincinnati	\$ 380,744			\$ 380,744	\$113,744	\$ 267,000
Pittsburgh	515,000	\$406,150		921,150		921,150
Baltimore	451,193			451,193	70,000	381,193
Birmingham	None					
Jacksonville	None					
Nashville	85,000			85,000		85,000
New Orleans	*201,250		\$1,710	202,960	44,887	158,073
Detroit	None					
Little Rock	85,008			85,008		85,008
Louisville	175,275	560		175,835	40,000	135,835
Memphis	None					
Helena	15,000		**161,438	176,438	77,738	98,700
Denver	None					
Oklahoma City	65,000			65,000		65,000
Omaha	165,000	32,975		197,975		197,975
El Paso	39,004		**107,796	146,800		146,800
Houston	65,843		143,323	209,166		209,166
Los Angeles	None					
Portland	None					
Salt Lake City	115,080			115,080		115,080
Seattle	None					
Spokane	None					
Total	\$2,358,397	\$439,685	\$414,267	\$3,212,349	\$346,369	\$2,865,980

*Net

**Completed buildings

of later needs That they were the means of mulcting the government or of depriving it of cash which undoubtedly belonged to it, was undoubtedly a fanciful or imaginative way of attacking the system—nothing more The government was and is the residual claimant of all property belonging to reserve banks in the event of dissolution after the return of the value of the stock to members, and whether this residual claim of the government takes effect upon cash or securities or upon buildings was (if the building were wisely and economically constructed) a matter of only secondary interest Congress, however, devoted to the question of buildings and costs much time which might to great advantage have been spent in considering serious problems relating to the management of reserve banks, and the building program was unmistakably used to foment prejudices on the part of the agricultural element against the so-called financial interests which were represented

as reveling in palaces and enjoying luxuries bought with earnings which had been wrung from the member banks and from the public by the use of monopolistic powers. To all such charges little or no attention could be paid except from the standpoint of immediate or everyday political effect, although they serve to explain the rapid loss of the system in prestige subsequent to the year 1919.

Policy of Publicity

A great deal of the controversy and suffering connected with the reserve system might undoubtedly have been avoided had the reserve system been willing to adopt a policy of greater publicity and openmindedness with the nation. In the beginning of the organization the Federal Reserve Board had wisely adopted the plan of absolute publicity so far as at all reasonably possible. It not only gave out to the newspapers its annual report in the appendices, to which were carried not only a detailed account of its own expenses with the names and salaries of every employee, but it also required the reserve banks to do likewise and it printed the results as an exhibit to its own report. Only a few months after the organization of the Board, beginning in May, 1915, it authorized the Secretary of the Board to begin the publication of a monthly bulletin whose purpose it was to give both to the reserve banks and to the public authentic information concerning the doings of the Board and the banks and detailed statistics of operation. This bulletin was subsequently expanded in such a way as to provide for careful reports on business conditions, especially as affected by credit changes and by reserve banking in general, such reports being prepared in the several banks and forwarded to the Board, which either published them in full or prepared from them its own national digest and review of the entire situation.⁵

⁵ This Bulletin was published under the direction of the Secretary's office until September, 1918, and was then transferred to a new Division of Analysis and Research, of which the then Secretary of the Board became Director, continuing also as Editor of the Bulletin (so designated by the Governor of the Board) until July, 1922, when he became Consulting Economist to the Board, remaining in that connection until October, 1922, when his resignation (filed May, 1922) took effect.

The policy was exceedingly helpful, not only in maintaining a substantial amount of interbank knowledge and communication, but also in keeping the public advised thoroughly of the doings of the reserve system and of the reasons for its various policies. Over and over again during the first one or two years of the system's history did congressmen who had believed themselves the possessors of "inside" information which would serve as a basis for investigation, find upon inquiry that the facts about which they asked had already been published in the Board's annual report or in the Federal Reserve Bulletin and that there was therefore no mystery or concealment upon which charges or indictments of the familiar legislative type could be founded. The Board undoubtedly reaped large dividends from this policy of openmindedness and sincerity, but as time went by the difficulty of maintaining the policy became more and more evident. Federal reserve banks were extraordinarily reluctant to have their salary rolls published, urging that it created jealousies in their own staff, an argument which of course had little or no basis and which readily implied weak administration or the existence of nepotism and favoritism. Nevertheless they succeeded for two or three years in prevailing upon the Board to modify the system of publicity so that salaries were merely lumped and only those of the larger officers given separately. The Board also adopted the plan of publishing changes in salaries only after the lapse of a year, those which were published at the end of, say, 1915 being those paid during the year, changes made in December, 1915, and being effective January 1, 1916, being published only at the end of 1916 as having been paid during the latter year. This largely deprived the reports of their up-to-date quality when the practice became known and tended to prevent members of Congress from taking them at the full value.

There developed more and more reluctance to give to the public the absolute facts in such matters, about buildings, earnings, and the like, and although they were published in one

form or another from time to time, this was often done in a way as to attract the least possible attention to them or perhaps were held back for an unduly long time. No one, certainly, could charge the Federal Reserve Board or the system at large with being more secretive than the rank and file of government bureaus, and certainly no one could intimate for a moment that they were more secretive than foreign central banks. Indeed, at one time an ex-officio member of the Board, after being a great advocate of publicity, complained of the fact that the Board was publishing too much in a way of details and especially protested against the complete weekly statement which was being issued, basing his complaint on the ground that the Bank of England did nothing of the kind. During the war members of the Board who believed themselves ultra-patriotic, at times complained of the action of accounting officers in preparing the weekly statements in such a way as to show (what was the truth) an overdraft on the part of the government in certain of the reserve banks. There was undoubtedly a violent reaction against the Board's policy of complete openness and frankness toward the public, and although this did not manifest itself fully for a good while or become known to the public or Congress completely for some time, it did eventually make itself felt, with the result that the good influence of the earlier policy of publicity was in a measure destroyed.

These facts are worthy of record for the light they throw upon certain phases of government activity under an autocratic system of administration as well as for their psychological value in connection with all undertakings of a like sort. Had the Board and the system at large been willing to pursue the policy of complete publicity to the very end, basing its action upon the ground that the banking system belonged to the people and was not a private capitalistic enterprise, it might have avoided or anticipated much of the bitter criticism to which it was later subject, while by knowing the direction of public dis-

cussion it would have been able to reshape its own policy and to avoid doing many things that were afterward regretted. The question how far it is practicable in any such undertaking to focus the attention of the business community upon technical financial problems, is always open to doubt. It is certain that so far as possible every effort should be made thus to center study and discussion, since in that way only can there be assurance of public confidence and avoidance of later misunderstanding and effort to misrepresent.

APPENDIX TO CHAPTER LXIV

LEGISLATIVE HISTORY OF THE ENLARGEMENT OF SURPLUS

Senate Bill 5236, an act to amend sections 7, 10, and 11 of the Federal Reserve Act and section 5172, Revised Statutes of the United States, was introduced by Mr. Hitchcock on December 18, 1918, and referred to the Committee on Banking and Currency. When reported back on January 9, 1919, with Senate Report No. 636, Mr. Hitchcock asked for immediate consideration, as the passage of the bill was urgently requested by the Federal Reserve Board.

The purpose of the bill was in the first place, to permit Federal reserve banks to use their earnings and to increase their surplus up to 100 per cent of capital, a provision which was limited by the old law to 40 per cent. Mr. Hitchcock explained that the reason for this change was, that the deposits and note issues of these banks had grown very largely on account of the war, much beyond what had been anticipated, so that at the time being capital and surplus of these banks amounted to only 2 per cent of their total liabilities. "For instance, the Federal Reserve Bank of New York City has a capital of only \$20,000,000. It has obligations greater than has the Bank of England and yet the Bank of England has four times the capital of the Federal Reserve Bank of New York City." (P. 1156, Record, 65th Congress, 3d session.)

The other amendment reported favorably by the Committee provided for enlarging the amount of notes of any one customer, so that a Federal reserve bank could discount for a member bank. The provision authorized the Federal Reserve Board upon the affirmative vote of not less than five of its members by a general ruling covering all the districts, to permit the Federal reserve banks to discount for any member banks notes to the extent of 20 per cent of their capital.

and surplus for any one customer, provided the notes were secured by United States bonds in addition to the other securities. The purpose of this provision was to give additional value to Liberty Loan bonds and to enable persons or firms who had become burdened with such bonds, to negotiate loans by using the bonds as collateral instead of having to throw them on the market. Objection against this section was raised by Messrs Smoot and Pomerene for the reason that they considered such practice against all principles of safe banking, but it was admitted, on the other hand, that the provision, if limited to a certain period, might be admissible.

In debate on January 20, some Committee amendments were offered. The first was to strike out section 2 relating to section 10 of the Federal Reserve Act. This section had been designed to permit members of the Federal Reserve Board (except the ex-officio members) to be elected to positions in member banks immediately after the close of their terms of office on the Federal Reserve Board (The original act prohibited such election for two years after the close of a term.) The other Committee amendment struck out the words "issued since April 24, 1917" in section 11, subsection (m). This was not accepted since these words were meant to confine the provision to Liberty Bonds in order to make them, and them alone available as security. Mr Schafroth's amendment to section 3, providing that the section should not be operative after December 31, 1919, was accepted, and, thus amended, the bill passed.

The House Committee reported the bill to the House with amendments. It added a section on branch banking (amending section 25 of the Federal Reserve Act) and withdrew section 2 of the original Senate bill relative to members of the Federal Reserve Board.

Because of Mr Mann's objection against immediate consideration unless the section on branch banking was taken out, and because Mr Phelan considered the other provisions of extreme importance, section 4 was stricken out by unanimous consent. The bill was agreed to in the House on February 17.

The conference committee recommended that the Senate recede from its amendments and agree to the amendments of the House with an amendment. The bill as agreed to differed little from the original Senate bill.

Section 1 related to the earnings of the year ending December 31, 1918. The provisions of subsection (m) in section 11 of the Federal Reserve Act were to be operative not longer than December 31, 1920, the section furthermore referred to "notes" and bonds for the reason

that the next government issue was contemplated to be in form of notes and not of bonds

The conference report was agreed to in the House on February 26, and in the Senate on March 2. The bill was signed on the following day

CHAPTER LXV

THE BUSINESS REACTION—ITS EFFECTS

Reluctance to Admit Reaction

In studying the years 1921 and 1922, the observer of industrial conditions will do well to place large emphasis upon the reluctance of business men as a group to admit the existence of reaction in trade. Undoubtedly there had been not a few who were of the opinion, after the war was over, that a régime of high prices could be maintained, if all would stand together and support one another. Price-fixing had reached a stage in its development far more advanced than any that had been previously attained, and had been sanctioned during the war, tacitly if not openly, by governmental authority. Not content with stability of prices, producers had used their improved organization subsequent to the close of the war to advance prices, and had succeeded so eminently in this regard that they had actually put prices up a good deal higher in spite of large volume of production than they had been toward the close of the war when lack of "man-power" tended to cut output.

Price-Fixing Machinery and Reaction

But could this price-fixing machinery resist the natural effects of reaction? This question was to be tested and answered during the years 1920-1921. In former times of depression, it had been regarded as axiomatic that sharp recessions should from time to time occur, with correspondingly bad effect on business. It was now desired to stand more closely together and to refuse to cut prices, banks and manufacturers supporting one another, and the whole fabric of

industrial society being strengthened thus to maintain itself, notwithstanding that there would normally have been a basic reconstruction upon which new superstructures of demand and supply would have been gradually reared. The experience of the year 1920-1921 threw light upon the feasibility of the new method which producers were thus anxious to exploit, but hardly commended it to the community.

The first symptoms of serious reaction in business had been afforded by the fact that buyers would not purchase in domestic trade. This unwillingness speedily extended itself to foreign trade, assuming shape there as the so-called "cancellation evil"—foreign buyers (or would-be buyers) refusing to live up to their agreements and repudiating contracts. Ordinarily, such a situation would have been met by an effort to meet public demand through reductions in price designed to induce the consumer to buy more freely. As a matter of fact, such reductions did automatically occur in the producer's charge for staple food products, as well as in staple raw materials such as rubber, leather and various others. Price-fixing machinery, however, was powerful enough to prevent corresponding recessions in wholesale and retail prices, with the result that the consumer realized the results of the reductions only slowly if at all. In fact, it may well be doubted whether he actually got the benefit in any extensive line of the reductions in value which took place.

Production and Prices

So strikingly significant was this irregularity or unevenness of price recession as a feature of the downward movement in business, that the principal factors of the development are worthy of especially careful note because of the bearing they have upon general panic and depression as economic phenomena.

The period was one of readjustment. In leading industries there has been a tendency toward lower price levels, as well as

to a new and more stable relationship between forces which affect conditions in marketing. In certain industries this tendency had gone further than in others. This was noticeable in textiles. Thus there had been, by the middle of 1921, a marked increase in cotton consumption, in wool consumption, and in the importation of raw silk. Similarly, there had been an improvement in boots and shoes during the spring of 1921, in particular in the women's branch of the industry. On the other hand, in some lines the situation continued to have many elements of uncertainty. In the iron and steel industry, pig-iron production during April, 1921, was the lowest since June, 1908, while May production was but slightly better. Steel-ingot production had shown a similar tendency. The non-ferrous metal industries had experienced a radical decrease in prices, together with great curtailment of production schedules.

Varied tendencies were shown in the fuel industries. Bituminous coal production reflected the change in the industrial situation, and had shown a steady decrease during the year, until in May it amounted to only 66 per cent of the figure for December, 1920. On the other hand, crude petroleum production during the year had shown an equally steady increase. Anthracite coal production on the whole had been well maintained. The construction industries had reported an increase during the spring of 1921, although this had been due in a measure to seasonal influences. After a considerable decline in production and shipments, which was likewise partly seasonal, the lumber had also experienced considerable increase in activity.

The agricultural situation had felt the same influences. In general, the yield of the various crops during 1920 was large. The cotton crop in particular was the largest on record since 1914, the final estimate being 13,197,775 bales. Until recently, prices have tended to decline, and as a consequence there was a general disposition on the part of the growers to hold stocks in anticipation of more favorable marketing conditions, as well

as in certain cases a tendency to leave the lower grade portions of the crops ungathered. Grain stocks on the farms remained very large, the Department of Agriculture reporting the amount of wheat on farms on March 1 as 26.4 per cent and the amount of corn as 48.6 per cent of the 1920 crop. On March 1, 1920, only 17.6 per cent of the wheat and 37.5 per cent of the corn crops of 1919 remained on the farms. The receipts of grain at 17 interior centers during the crop year were 5 per cent greater than they were a year before, while sight receipts of cotton were only 82 per cent of those in 1919-1920. Marketing was somewhat delayed and the movements had been heavier during the later months of the season than in the previous year. The shipment of live-stock to market had likewise been considerably lower than the year before, although it should be noted that the movement during the season 1919-1920 was extraordinarily heavy. The live-stock industry had also been seriously affected by the low levels toward which prices had tended.

Corresponding to the general industrial situation, the volume of wholesale trade had shown in the first half of 1921 considerable decrease in various lines. During the spring some revival in general had been noted. The volume of retail trade, on the other hand, had been better sustained, although measured in money values it had been less to date this year than during the corresponding period the year before in particular in the South and West.

Labor and Industry

Complaints of a shortage of labor, especially in the rural districts, were still common, although the alarming increase in cancellations of orders placed with manufacturers, together with fuel shortage and transportation hindrances, had already produced a considerable measure of unemployment. During the latter part of June and in July the decreasing demand for factory labor was the subject of quite general comment. The

New England textile mills and the leather and shoe industries were among the first to be seriously affected by cancellations of orders, leading to a sharp curtailment of output. Despite price concessions in some lines, notably textiles, there was little evidence of a revival of business activity during the fall months, and in consequence the year 1921 opened with a serious lack of employment still manifest in the eastern districts of the United States. At the opening of the year these conditions became more pronounced, although there was some resumption of activity in the industries which had been the first to feel the effects of depression, and opportunities for employment in such industries increased as time went on. The iron and steel industry and transportation interests, however, began to be affected by lack of business.

A special inquiry into conditions of employment and changes in rates of wages undertaken by the twelve federal reserve banks at the request of the Federal Reserve Board showed that establishments having 1,737,000 persons on their pay-rolls on April 1, 1920, were employing only 1,303,000 on April 1, 1921. An exceptionally high degree of unemployment existed in reporting automobile lines (55.2 per cent), in building construction (60.4 per cent), and in iron and steel (41.5 per cent). Although considerable decreases were shown in the average weekly earnings, a very considerable part of this loss was undoubtedly due to reductions in working time. The reports indicated, however, that rates of pay had been reduced in the textile mills among others, and that such reductions had been especially pronounced in the South. Common labor had everywhere had its rates of pay sharply cut.

These conditions were, of course, more or less directly reflected in banking, although (as already elsewhere seen) only after a considerable "lag" had occurred. The effort to maintain prices, so widely undertaken by business men, was successful only in certain branches of business, and, in a measure, at retail. But the fact that it succeeded at all tended to make

the process of readjustment slower and more difficult, and to hamper the efforts of the banking system to bring about a more satisfactory state of things. Nevertheless, as the year 1921 advanced beyond its earlier months, it became more and more manifest that the panic danger had practically disappeared with the old year and that whatever hazard there had been of acute crisis, had been converted into the familiar type of "depression" instead. There was nothing that the reserve banks in these circumstances could do to relieve conditions. They continued to advance funds when needed, while the reduction of discount rates which (as already seen) had been initiated in the spring of 1921 was continued until it reached low points, with a general rate of $4\frac{1}{2}$ per cent accompanied by a 4 per cent at three banks—New York, Boston, and San Francisco.

Important Banking Effects

But, while the movement of the portfolio of reserve banks down to low levels during 1921, continued steadily to testify to the recession in activity of business all over the country, sundry indirect banking effects of first-class importance began to exhibit themselves. Of these, possibly the most retail thing were those which had to do with the commercial high measurement. We have already seen how, after the war, the Reserve Board had, in a somewhat hesitant way, endeavored to get back to the operation of the banks on a commercial paper basis. This had been done by abolishing the preferential rate in favor of government notes and by trying to drive "war paper" out of reserve banks. The effort had been only tentative, however, for there was so vast a volume of government obligations in circulation everywhere that member banks, instead of offering eligible commercial paper, found it far easier to equip themselves with a satisfactory supply of Treasury notes or Liberty bonds, either by buying or borrowing them, then using them as a basis for current credit through direct borrowing.

at reserve institutions. Of course, this was an unfortunate way of meeting the situation growing out of the war, even though the Board had attempted to do something in the direction of reducing the war portfolios. Every step in this direction, moreover, had been met with strenuous resistance by member banks which had found themselves overburdened with holdings of war securities, and the result was to create a strong temptation to reserve officials to favor policies which would make it easier for members to bring in commercial paper, they being thus induced to return to a business paper basis through the ease of discount rather than through any strict regulations requiring adherence to principle.

Abuse of Bankers' Acceptance

The early abuses of the bankers' acceptance have already been traced at some length. They had been apologetically noted both in Washington and among financiers, the view being taken that they were the product of war and that after the war was over they would soon be done away with. The Reserve Board had issued to member banks a lengthy letter in which it urged them not to discount and hold their own acceptances, and it had endeavored to induce them to give up the bad practice of making acceptances for the purpose of carrying warehoused products. In all this but little success had been had, many large banks admittedly "working" the acceptance market "for all it was worth," and "dumping" upon reserve banks slow paper in the form of acceptances, with the entire consciousness that what was being done was merely to put through a good deal of accommodation paper for purposes of convenience, taking advantage of the good nature of reserve bank officials or of their desire to enlarge the use of acceptances.

Thus deep-seated financial evils had begun to display themselves, a fact which became unfortunately evident during the summer of 1921, when several large New York banks were in a seriously embarrassed condition—a number of institutions

engaged in the foreign trade closing their doors or retiring from business, or transferring their assets to other banks, while foreign branches were closed in considerable numbers because of the losses which they had incurred, in not a few cases through the abuse of the acceptance method of financing. The effect of this situation was to cut the total volume of acceptances, which had once been reckoned at about \$1,000,000,000, to not over \$400,000,000 at the close of 1921, and, although some subsequent expansion took place, it was plain that the bankers' acceptance had lost prestige during the depression. A committee of bank examiners which reported to the Comptroller of the Currency in June, 1922, found extensive and serious abuses involving renewals, the making of long-term paper in acceptance form without underlying transactions to liquidate it, and generally unsound banking operations as a basis.

All these factors combined to weaken confidence in the idea of a discount market and to lessen the prestige of the federal reserve system. The Reserve Board, anxious to win the public back to a larger use of acceptances, first increased their maturity to six months as against ninety days in foreign trade—later also in domestic agricultural operations. During the latter part of 1922 it issued circulars practically abandoning all effort to apply stringent regulations of control of acceptance practice and throwing the matter into the hands of reserve banks themselves, notwithstanding that some of the latter had really sponsored bad methods by countenancing or tolerating them on the part of local banks and business men. All this of course indicated a weakness in the oversight of the system which could not be concealed and which tended to repel support and respect rather than to conciliate friendship.

Trade Acceptances Discredited

The discredit which had fallen upon the bankers' acceptance came in for larger measure to the trade acceptance. Dif-

difficulties of practice and the errors of theory which had been obstacles during the early development of this type of paper have already been surveyed at some length and need not be repeated. They were in no sense lessened after the close of the war, but, on the contrary, the difficulties connected with them grew greater rather than less as the business structure resumed its normal form and functions. When the peak point of prices had been passed, and when reaction had become definitely established, it was found that a large element of unsound trade acceptances had been made and had been foisted upon incautious banks by business houses which had taken advantage of the widespread propaganda in favor of this type of paper to help themselves as liberally as they could to accommodation which they might not otherwise have obtained in any such quantity. "Bank house-cleaning" during the early months of 1922 in many cases involved the writing off of great quantities of poor trade acceptances or the definite recognition of them as long-term, slow paper which could not be collected.

Altogether, the effect of the depression must be reckoned as having been that of decidedly damaging a certain type of financing which had apparently been disposed to gain ground during the period before the war, and which at least had held its own during the height of the struggle, many believing that it would not be long before a restoration of sound business would bring the trade acceptance back into favor. Instead of any such result, the abuses to which the paper had been subjected became more and more evident, with the result that the reserve system received another shock to its prestige, due to the fact that, although it had recommended and sponsored this type of paper, the paper itself had lost ground in public estimation and had shown no capacity to overcome the prejudice aroused in the minds of strict thinkers on bank and commercial credit by reason of the doubtful character of many of the acceptances that had been issued.

Decline of Reserve Ratio

The steady decline of the reserve ratio at some of the interior banks, although offset by funds transferred to them through the process of inter-reserve rediscounting already described, was fully perceived by the public—indeed there was no attempt to conceal the facts in the case, but quite the contrary. Instead, however, of regarding this as exhibition or demonstration of reserve bank power to help and to strengthen conditions, the banking community undoubtedly felt that it displayed an inability to control the operations of the weaker reserve banks. There was a widespread tendency to criticize the Board at Washington for allowing banks, like those at Atlanta and Dallas, to become so heavily overburdened with frozen assets, and as a result to reduce their available reserves, at some times almost to the vanishing point. Business reaction was thus mirrored in this condition of non-liquidity even at reserve banks, and the business public felt, and with reason, that the reserve system had allowed itself to come very close to the brink of disaster. This view of the situation was only slowly relieved by the reductions which were gradually effected in reserve bank portfolios.

Change in Resources¹

Recovery was necessarily slow. Comparison between conditions existing during 1920 with those which had been attained at close of June, 1921, exhibit the results shown on next page.

The fact that the system had steadily increased in strength was in striking contrast with the decline in total resources which, although moderate, showed the reaction from the peak level. This decline in resources had been due to the gradual reduction of the amount of reserve bank advances and was best reflected in the change in the item of total earning assets, which was reported at the close of June, 1920, as \$3,183,-

¹ Discussion on pp 1452 ff was prepared by the author for Federal Reserve Bulletin, July, 1921, p 214

RESERVES, EARNING ASSETS, AND TOTAL RESOURCES OF FEDERAL
RESERVE BANKS

(In thousands of dollars)

	June 25, 1920	Oct 15, 1920	June 29, 1921	Percentage change	
				June 25- Oct 15, 1920	Oct 15, 1920- June 29, 1921
Total reserves	\$2,108,605	\$2,154,911	\$2,625,458	+2 2	+4 5
Total earning as- sets	3,183,275	3,421,976	2,060,495	+7 5	-35 3
Total resources	6,074,713	6,610,250	5,242,041	+8 8	-13 7

275,000, a figure which must be compared with a figure about a year later of approximately \$2,060,495,000. The decline of approximately \$1,120,000,000 thus reflected as the outgrowth of the year's operations in connection with earning assets should be compared with the increase in the same item during the year ended June 30, 1920, amounting to \$829,000,000. The volume of earning assets in 1921 was, therefore, little less than it was at the close of June, 1919. It is an interesting fact that the rate of reduction during the second half of the two-year period in question was so nearly identical with the rate of expansion during the first half of the period. The position of the system had thus been brought well back toward the point at which it stood when the war restrictions upon financial and productive activity began to be eliminated, not long after the armistice.

Of special interest in this connection is the fact that the reduction in the amount of bills held by the federal reserve system had been so noteworthy. Bill holdings at the close of June, 1920, were not far from \$3,000,000,000, while the situation at the close of June, 1921, showed slightly more than \$1,800,000,000 in bills on hand. A falling off in round num-

bers of over one-third, or \$1,200,000,000, in bills held, represented the results of operations during a year's time. Included in this reduction, it should be noted, was a decline in the bills secured by government obligations, which had fallen from approximately \$1,300,000,000 at the close of June, 1920, to approximately \$648,000,000 a year later. Other bills discounted amounted in June, 1921, to a little less than they had a year earlier, the net conclusion being, therefore, that the process of credit accommodation, so far as the federal reserve banks were concerned, had altered but little the amount of commercial paper discounted, but had taken effect primarily in the restriction of the loans collateralized by government war obligations.

Notes and Deposits

Of special interest to the general student of banking in connection with the operations of the federal reserve system were the changes in the volume of outstanding federal reserve notes as contrasted with changes in the deposit liabilities of the federal reserve banks. Comparing the figures given for the year 1920 with those for 1921, it will be found that whereas at the end of June, 1920, the volume of federal reserve notes in circulation was approximately \$3,117,000,000, the total in actual circulation a year later was approximately \$2,634,000,000—a falling off in round numbers, therefore, of over \$480,000,000. As contrasted with this reduction in the circulating currency of the system is to be noted a fall in total deposits from approximately \$1,916,000,000 in June, 1920, to \$1,686,000,000 in June, 1921. Since there had been but little change in the volume of government deposits during the year, the reduction which is thus shown to have occurred has taken place primarily in member bank reserve deposits and may be regarded as amounting to about \$191,000,000. The remainder of the decrease was partly due to the withdrawal of foreign government deposits. This should be contrasted with a growth

in deposits during the preceding year amounting to about \$14,000,000 and a growth in notes of approximately \$617,000,000

Attention was called in 1920 to the fact that the immense increase in the note circulation during the year 1919-1920 was undoubtedly due in some measure to the fact that a larger amount of circulating currency was required because of the great advance in prices and the consequent necessity of carrying a larger supply of money in pocket with which to meet ordinary requirements. The recession in the total amount of notes in circulation may be ascribed to a movement exactly parallel but opposite in direction. As prices fell, the factors already referred to lost in intensity, while other factors which had tended to enlarge the circulation of federal reserve notes—such as the process of substituting them for gold and silver and of exporting them in large amounts to Central American and West Indian countries—ceased to operate. Indeed, in some cases the reverse flow had doubtless set in. The significance, therefore, of the situation was found in the fact that the reduction in outstanding circulation which had occurred represented a corresponding change in the actual use of notes by the public. The movement of the items “notes” and “deposits” may be followed to good advantage in the table on following page.

Discount of War Paper

Perhaps the most interesting element of change in the portfolios of reserve banks during the year 1920-1921 was the lessening of the volume of war paper, or, to use the technical expression, “bills discounted secured by United States Government obligations.” These fell off to approximately \$648,000,000. A gratifying feature of the post-war development of the investment and financial mechanism was the ability thus shown on the part of the public to absorb the outstanding obligations of the nation, both in short and long-term form.

FEDERAL RESERVE NOTES IN CIRCULATION, DEPOSITS OF FEDERAL
RESERVE BANKS, AND NET DEMAND DEPOSITS OF
REPORTING BANKS

(In thousands of dollars)

Dates	Federal reserve notes in actual circulation	Total deposits of federal reserve banks	Net demand deposits of re- porting member banks
June 25, 1920	\$3,116,718	\$1,916,086	\$11,347,041
Oct 22, 1920	3,356,199	1,816,289	11,240,588
June 29, 1921	2,634,475	1,685,788	10,046,398

The existence of substantial investment capacity laid the foundation for the absorption of government bonds and certificates, while the policy of the Treasury Department in meeting market rates of interest enabled both member and reserve banks, which had become large holders of "war paper," to reduce this element of their portfolios in very material degree. Treasury certificates pledged with federal reserve banks at the opening of June, 1921, were only \$55,000,000, while of a total of over \$4,000,000,000 of Victory notes, only \$188,000,000 were in the hands of member banks in leading cities. The wholesale transfer of the evidences of government indebtedness from the banks to the people was aided by the federal reserve system, which had ceased to encourage the carrying of such paper by preferential treatment of loans collateralized by public obligations. During the year such preference, originally granted in aid of the placement of Liberty bonds, had practically disappeared.

The disposition of investors to absorb and "digest" government obligations, taken in conjunction with the policy of the federal reserve system already referred to, tended strongly to curtail the large holdings of paper collateralized by government obligations which had been built up during the war and post-war expansion period in the federal reserve banks. The progress during the year 1920-1921 may be contrasted with

changes during the year 1919-1920 At the close of June, 1919, the total volume of paper secured by government war obligations held by federal reserve banks was about \$1,573,000,000, and operations during the following year had reduced the amount by only \$300,000,000 Progress during the past year was thus more than twice as rapid The situation is reflected in the following table

HOLDINGS OF BILLS DISCOUNTED BY FEDERAL RESERVE BANKS
(In thousands of dollars)

	June 25, 1920	Sept 3, 1920	Dec 3, 1920	June 29, 1921	Percent- age de- crease
Secured by govern- ment war obliga- tions	\$1,277,980	\$1,332,892	\$1,160,685	\$ 647,761	*51 4
All others	1,153,814	1,412,035	1,616,116	1,123,801	**30 5

* From September 3

** From December 3

CHAPTER LXVI

THE FEDERAL RESERVE SYSTEM AND AGRICULTURE

Speculation in Agriculture

As the deflation period proceeded it became more and more evident that a very considerable proportion of the suffering of the transition was likely to be visited upon the farmer. This was for a variety of reasons. As we have seen, foreign trade had begun to pass through its era of contraction considerably earlier, while the stock market had probably suffered from the effects of depression and contraction soonest of all. Agriculture did not feel the effects of recession in business as soon as other industries, partly because of the continuation of the government guaranty of wheat prices for some time after the war, partly because of the urgent need of American food products abroad, and partly because of relatively short or scanty crops in other parts of the world. But eventually it was certain that agricultural industry must pass through the same period of suffering and recession that had presented itself in every other branch of economic life.

It was the more nearly unavoidable that this should be the case because of the extensive speculation which had developed in agriculture and the products of the industry during and after the war. The government had made the mistake of "pegging" the price of wheat at an unreasonably high level in the early days of the struggle, while cotton, whose price was never interfered with by the government, had gone to fabulous values because of the many uses to which it could be put in connection with the manufacture of munitions, hospital supplies, and other war requirements. Other agricultural products

had been partly "stabilized" by the sympathetic effect of the price-fixing in staples, and still others had experienced unusually keen demand because of special war necessities. So the whole fabric of agricultural prices through the demand and selling conditions just described, had been lifted to a very high level of expansion early in the war, and there had been no reason for a subsequent change.

The effect of these enormously high prices and the exaggerated demand was speedily seen in the development of very high land values. Practically throughout the country the high prices of agricultural products began to be translated into capitalized values for the land on which the products were turned out. Many farmers seized the occasion to pay off their mortgages, but a much greater number sold out at high prices to others and retired from business. A very large number undoubtedly were seized with a speculative fever and purchased more and more land, giving mortgages in payment for it, notwithstanding that the settlement of such obligations was practically out of the question unless agricultural products continued on the same high level that they had reached during and just after the war. Agriculture at the beginning of 1920 was undoubtedly a highly speculative and overinflated type of business.

Credit Requirements of Agriculture

In order to understand the exact situation at the beginning of 1920, and to trace the events of the succeeding two years, it is now necessary to go back and to consider briefly the general credit requirements of agriculture and the provisions which had been made for meeting them. When the Federal Reserve Act was under consideration, it had met with great opposition from the farming element (or from its supposed representatives in Congress), as will be recalled by those who have studied the process by which the Federal Reserve Act was gradually worked out. The opposition to the act at that

time was based upon the belief that it did not allow a sufficiently long period of maturity for farm paper, and that it therefore tended to discriminate against the farmer. This had been partly cured in the estimation of farm credit advocates by raising the maturity of the paper to six months, or double the maximum maturity for commercial paper, but the extreme advocates of farm credit had failed to incorporate into the measure such "soft money" schemes as they had then desired to graft upon it, so that while it made ample concession to legitimate farm paper, it did not allow for issues of notes secured against products themselves without cash reserve, nor did it grant to reserve banks authority to provide working capital for the farmer through long loans or through the purchase of mortgages. All of these proposals and many others had come forward at various times in the course of the legislation, but had never received any countenance from administration leaders and of course none from Chairman Glass who was in charge of the legislative contest in Congress. During the course of the struggle, however, some partial compromise had been unofficially made with farm representatives in Congress, it being suggested that after the Reserve Act was out of the way it might be possible to consider the preparation of a genuine farm credits bill.

Antecedents of Farm Credit Bill

Such a bill had already been given rather extensive study. In 1911-1912 a commission of Congress had gone abroad for the purpose of investigating methods of extending agricultural credit in various countries. Most of the attention of this commission had been given to long-term farm mortgage credit, and it had been especially attracted by the German system of farm co-operative rural credit organizations, which financed their members by creating mortgages and selling them to land banks. The banks obtained funds from investors by issues of debentures which the latter purchased and held for long peri-

ods This type of agricultural credit had been elaborately and skilfully worked out in Germany, and less highly developed plans had been put into effect in most of the other European countries In some, the success attained in securing money for the farmer on very long terms and at low interest had been great The agricultural commission, therefore—whose origin was largely due to the desire of farmers to obtain lower interest and better terms of borrowing in order that they might be freed from the exactions of local money lenders, particularly in the western states where interest sometimes ran as high as 10 or 12 per cent gross—was inclined to specialize in mortgage credit Nevertheless some members of the commission had also come to the conclusion that it would be very desirable to make some provision for so-called "personal credit" in agriculture, in order that the tenant farmer, or the farmer whose land was already mortgaged up to or beyond a safe limit, might nevertheless get accommodation in time of special difficulty or trial, or under certain circumstances might be furnished with working capital which would enable him to carry on his operations at least upon a limited scale.

. The outcome of these investigations and inquiries had been the so-called Moss-Fletcher bill, so named from the fact that it was introduced simultaneously in an identical form by Representative Moss of Indiana in the House, and in the Senate by Senator Fletcher of Florida The Moss-Fletcher bill was hardly a feasible measure It was patterned closely upon foreign methods and had but little genuine adjustment to American agriculture Its authors assumed that foreign financing methods could be simply transferred to this country and implanted without any difficulty whatever That of course was a serious error, because of the fact that rural credit, more than perhaps any other kind of credit, depends closely upon the special interests, requirements and peculiarities of the local producer The Moss-Fletcher bill, moreover, had been drafted without very much study of the technique of bond issue, so

that it was regarded by careful students as lacking a good many necessary features whose introduction would be essential in order to make it a successful working piece of legislation. Members of Congress, however, eager to do something for the farmer, did not appreciate these defects in the Moss-Fletcher bill, and some of them were inclined to think that if it could be passed just as it stood, it would be of great benefit to the agricultural element among voters.

Various other more or less extreme rural credit schemes were drafted, some of them calling for liberal government aid or subsidy. Among these was the so-called Bathrick bill and numerous variants. Proposals to amalgamate some of these bills with the Federal Reserve Act had been definitely refused, but the partial promise to allow consideration of them in the Banking and Currency Committee of the House was taken by their advocates as committing that organization to action as soon as the Reserve Act was disposed of.

Attitude of Administration

The attitude of the administration, however, was not very cordial. As the Reserve Act advanced nearer and nearer toward reality, members of the administration began, as has already been seen in earlier chapters, to feel that they had taken on a very heavy load and one which they perhaps could not successfully carry through to destination. To add to this great undertaking another which perhaps would be equally onerous, was thought by many conservative Democrats to be a proposal of utmost hazard. Not only this, but many careful legislators were of the opinion that the Reserve Act would do about all that was necessary for agriculture. As has been elsewhere seen, the Reserve Act had in fact authorized national banks to make and carry a considerable amount of mortgage loans, while with the very liberal provisions for discounting agricultural paper which had been included, it was believed that the average country bank could be quite thoroughly

financed Chairman Glass definitely took the point of view that, with the Reserve Act in successful operation, there need be no further anxiety about farm credit for the present. President Wilson, although making no public expression on the subject, was understood to be very much in accord with this point of view and to feel that it was best to try the organization of the reserve system before undertaking something else.

Framing a Credit Bill

None the less, a strong and representative element in Congress remained determined to frame a new measure, to be known as a general rural credit bill. Their determination in the matter became manifest in but little more than a month after the adoption of the Reserve Act, and it was plainly stated to the House Banking and Currency Committee by members of that body that as they had yielded to the adoption of the Reserve Act, so they now expected others to yield to them through the preparation of a farm credit bill. In the Senate Banking and Currency Committee, opinion in favor of some farm credit bill was considerably stronger than it was in the House. Eventually a Joint Committee on Rural Credits was established, such Committee being made up of members drawn from the House and Senate Banking and Currency Committees, and began work in the early spring of 1914.¹ On the whole, the Committee turned out to be a tolerably harmonious body. The extreme agricultural element had reconciled itself to the necessity of preparing a tolerably moderate bill in view of the prospect that they would attain no success in any other way. The ultra-conservatives, who were not particularly in evidence among the membership, inclined to the view that it would be well to make, once for all, a definite compact with the farmer, giving to him his own credit system,

¹ The author became Expert to this Joint Committee on Rural Credits and was assigned the duty of drafting the measure to be taken up by the Committee. This measure passed through six successive drafts, eventually becoming the so called Hollis Bulkley bill which was introduced in the House on May 12, 1914 (S. Doc. 5542, 63rd Congress, 2nd Session).

and thereby perhaps relieving the reserve system of dangers which it might otherwise encounter

It was agreed, in response to recommendations made to the Committee by its expert, that the new system be modeled upon the same general broad lines as the federal reserve system—that is to say, that it be made a distinct system with full provision for local self-government and with the governing body located at Washington. With this general basis of agreement went the further understanding that, in so far as the provisions of the Moss-Fletcher bill could be incorporated or employed in the ultimate draft, they should be given a place there in order to conciliate the support of that section of Congress which had supported the Agricultural Commission of Inquiry and had favored the Moss-Fletcher bill in its earlier stages. Conditioned by these general understandings, the Hollis-Bulkley bill was gradually developed and placed before Congress

Outlines of Hollis-Bulkley Bill

The Hollis-Bulkley bill, although a highly complex piece of legislation, was simple enough in theory and since there were no local institutions through which loans could be made to the public, as was the case with the various independent commercial banks of the country, the Hollis-Bulkley bill set to work to create them. It therefore provided for what were called "farm loan associations." These were to be co-operatively established, somewhat upon the plan of local building and loan associations, as already well known in the cities. These farm loan associations were to make loans secured by first mortgage upon acceptable farm land to their constituent members or stockholders. Having made such mortgages, the farm loan associations were to sell them to a set of institutions known as "farm land banks," one of which was to be located in each of twelve districts corresponding roughly to the federal reserve districts. These farm land banks, after purchasing the mortgages, were to place them in trust as collateral security against

issues of debentures or bonds which were to be sold to the public. The public thus had the protection afforded by the capital of the land banks, with the underlying security afforded by the mortgages on farm land. The farm loan associations were bound to replace bad or doubtful mortgages on request, while their capital stock, although small, afforded some margin of protection in the event of breakdown. All farm land bonds were made claims upon the assets of the whole group of farm land banks and thus the system was woven into a single whole from the standpoint of liability. Detailed provision was made for the amortization of loans, the regulation of rates of interest, and the technique of farm lending generally. The bill in its technical aspects, indeed in its general conception, has undoubtedly been quite generally approved as representative of the experience of European countries, and since the debentures and other instrumentalities of land banks were to be free of taxation, the federal government might be said to have attained, therefore, the development of a sound farm credit system.

The radical wing of the Committee was, however, disposed to go further than this, by providing that the government should subscribe to the capital stock of the land banks in the event that it was not taken up through private subscription, a possibility of failure in public subscription which they had good reason for contemplating. Under the terms of the law there was obviously only a very narrow margin of profit in the land banks, while the farm associations, it was seen, would come into existence after, rather than before, the land banks, so that subscriptions to stock could not be expected to help at the outset. In addition to this, the radical wing of the Committee desired to have the Treasury assume an obligation to purchase the bonds of the land banks up to a specified sum, if at any time they should be offered on the market and not sold. These two provisions, of course, thus intended that the government should capitalize the land banks in the first place and

then purchase their bonds. In this form, the bill was very distasteful to the Wilson administration. It was referred to the then Secretary of Agriculture, Hon. David A. Houston, who reported against it, largely on the ground of its provision for governmental aid. Chairman Glass disliked it for the same reason, and while it apparently found favor in the Senate, the evident fact in the case was that it could not be expected to go much further. No progress with it was made, therefore, during the years 1914-1915.

Adoption of Farm Land Act

The agricultural credit agitation, however, had become very vigorous during the intervening months, and the Wilson administration was strongly reproached with having neglected the interests of the farmer. Secretary of Agriculture Houston was far from popular with the farmers of the country, being regarded as a "reactionary," and it had become known that he had opposed the rural credit plan. Toward the beginning of 1916 there began to be a rather general feeling among politicians that it would be an excellent plan to provide for the autumn campaign by adopting the Federal Farm Loan Act. Secretary McAdoo and Secretary Houston consequently got out the Hollis-Bulkley bill and in consultation with Chairman Glass ran through it, revising sections here and there, but not very materially changing its scope. Politically speaking, although neither of the men in charge was very much attracted by the idea of burdening the government in the way provided by the measure, it was thought best to yield to radical sentiment, and accordingly the provision for the government capitalization of land banks was retained, while permissive authority was given to the Treasury to buy the bonds of land banks in case of necessity. With these and a limited number of other modifications, the bill was reported from the committees of the House and the Senate, given perfunctory debate, and adopted. This enabled the Democratic party to go into

the campaign of 1916 with the record of having "taken care of" the farmer by giving him a credit system of his own upon a scale comparable to that which had been adopted in the Federal Reserve Act

Organization of Farm Loan System

The organization of the farm loan system, however, proved to be a very difficult undertaking. Not only was the establishment of farm loan associations slow, as it naturally would be, but the conditions growing out of the war were such as to retard development. The farmer, at this time, was in the full flush of war prosperity, and in many cases did not care to borrow heavily. The process of organization, therefore, continued only very gradually during the year 1916 and the early part of 1917, while at the same time difficulties of a serious nature developed which alone would have tended to prevent much success from coming to the system. One of these was the fact that the government had practically monopolized the bond market with its Liberty loans so that it would have been almost out of the question to sell any farm loan bonds, even if the Treasury had had no objections to seeing such bonds placed on the market in competition with the Liberties. Secretary McAdoo, therefore, thought it necessary to take up the first issue of farm loan bonds and to hold them in the Treasury, thus subsidizing agriculture to a limited extent. Other difficulties, however, were found in the fact that farm products were rapidly rising in price and land fluctuating to correspond, so that the farm loan associations could not be sure of the basis for their loans on a conservative footing. To add to this general difficulty, the farm loan system began to excite the opposition of critics because of its tax exemption features, and suits were instituted against it for the purpose of testing the constitutionality of such tax exemption. Of such suits the one which was eventually carried to the Supreme Court was decided and filed on February 28, 1921, and represented the

joint views of some of the most influential opponents and critics found among other mortgage bankers and dealers in mortgages who had felt that the adoption of the farm loan system was unfair to them because of its governmentally subsidized character.²

For all of these various reasons, the development of the farm loan system was extremely slow and the close of the war found it with only about \$132,000,000 of bonds outstanding. This was an extremely small sum as compared with the high expectations that had been entertained when the system was initiated. Moreover, the land banks were regarded by many as not holding out to the farmer a sufficient amount of aid. They were thought of as conducing largely to the welfare of the farmer who was already quite well financed, but as being too conservatively planned and operated to help the farmer who was in difficulties. Moreover, experience showed that the Farm Loan Act contained no provision for the extension of personal credit. This question had been carefully considered at the time when the act was first drafted, and it had been determined to omit personal credit and to make it exclusively a mortgage banking system. Such a decision meant that farm borrowings, designed to provide working capital and render possible the purchase and fattening of animals or the provision of farm machinery, could not be placed with the farm land banks.

Post-War Credit Problem

All this necessitated that the farm loan system, in an emergency produced by speculative conditions in agriculture, should stand somewhat apart. It was not intended to meet any such emergency, and the conditions which it aimed to meet were of the long-term variety rather than the short-term. So, for many reasons, it was evident after the war that, whatever aid agriculture might require in passing through the post-war

² Smith v. Kansas City Title and Trust Co.

readjustment, would not come, under any circumstances, from the farm loan system. When, shortly after the beginning of 1920, symptoms of recession began to be seen in all prices, the peak of the price movement being theoretically reached in May, there was no little anxiety as to source from which the farmer was likely to get aid. He could not expect it from the farm loan system. From the federal reserve system, encumbered as it was with large government loans made to finance the war, he could expect a reasonable amount of assistance but not more than that. The reserve system, moreover, was closely hedged about with regulations and requirements which would have prevented it, even if it had been so minded, from making very long loans to agriculture for any purpose. And yet it was evident that an agricultural crisis was practically upon the country and that very severe suffering and loss would necessarily follow in the course of it. This situation became evident to the Federal Reserve Board, as events unrolled themselves one after another, and the question was urgently presented whether it should adopt any measures which were distinctly favorable in a discriminating way to the farmer.

Discount Policy of Reserve Board

In its early discount policy the Federal Reserve Board had been consistently favorable to agriculture. This had been evident at the time of the organization of the system, when special concessions were made which granted a longer maturity for farm paper than for any other type of commercial instrument eligible for discount. The Federal Reserve Board, under pressure from politicians, had also shown a tendency to help agriculture in a very material degree—so far at least as discriminating credit could help it at all—by establishing specially low discount rates in its favor. An example of such rates was furnished by the 3 per cent rate to which reference has been made at an earlier point, designed to finance commodities in

warehouse, provided that those banks which obtained this rediscount rate should in return charge a rate of not over 6 per cent to their customers

Other examples might be cited, and among them the fact that the Board, even after this special compromise rate had been terminated, continued to make (up to about the time when the nation went into the war) a special "commodity rate" designed for the accommodation of the farmer. The rules and regulations of the Federal Reserve Board and its counsel's opinions relating to agricultural credit constitute an elaborate study in themselves, but, without attempting to go into detail, it may fairly be said that during the first six years of the Board's existence, these regulations had unquestionably strained every point to the furthest legitimate extent, for the purpose of allowing bona fide farmers' paper to gain admission to the reserve banks. Definitions of eligibility had been given in the shape of informal opinions which undoubtedly went the extreme limit of reasonable interpretation in making the paper created by the farmer, whether for the purpose of buying seed, or paying family expenses, or acquiring farm machinery, or for almost any other purpose even remotely connected with production, eligible to rediscount at reserve banks. It should be added that these openings had not been taken advantage of to the extent that they readily might have, had the country banks been more willing to help the farmer. In most cases the latter institutions did not want to help him particularly and they seldom if ever gave him the benefit of the rates fixed by reserve banks. They persisted in charging their own rates and they paid little or no heed to the fact that the reserve bank rate would have permitted them greatly to reduce their charges had they been so minded.

One result of this situation was to keep the amount of actual bona fide farm paper in the system down to a much lower level than it otherwise would have occupied. Nevertheless, the amount of credit which was used for the purpose of

developing and promoting agriculture in various ways, whether direct or indirect, had become large, so that there had never been a time when the farmer could complain with justice that he had been unduly deprived of accommodation

The facts in the case were somewhat reluctantly testified to by the Joint Congressional Commission of Agricultural Inquiry, which reported to Congress late in 1921. In that report there occurred the following statement ³

An analysis of the figures seems to justify the conclusion

1 That the expansion of bank loans in rural districts during the period of inflation ending June, 1920, was relatively greater than in the industrial sections, taken as a whole

2 That the action of the Federal Reserve Board and the federal reserve banks during the 15 months preceding April 28, 1921, did not produce a greater curtailment of bank loans in the rural districts than in the financial and industrial sections

3 Credit was not absorbed by the financial centers at the expense of rural communities for the purpose of speculative activities

4 That the pressure of the forces of liquidation and depression in the agricultural sections was reflected in a reduction of deposits. This reduction of deposits, particularly demand deposits, was relatively larger in the agricultural and semiagricultural counties in the United States than in the industrial counties

The Board's Own Analysis

The Federal Reserve Board itself at a somewhat later date when attacked in Congress, made a careful analysis of the agricultural situation the country over with a view to making up its mind how much credit had actually been obtained by the farmer, and eventually forwarded this information to Congress, publishing it at the same time in the Federal Reserve Bulletin. The essential facts were so remarkable as to warrant brief tabular reproduction as follows

Loans and discounts of banks in agricultural counties throughout the country declined \$37,000,000 (between May 4,

³ Report of Joint Commission of Agricultural Inquiry, H. R. Report No. 408, 67th Congress, 1st Session, p. 117

1920, and April 28, 1921), or slightly more than 12 per cent, the loans and discounts in semiagricultural counties declined \$19,000,000, or 13 per cent, and the loans and discounts of banks in nonagricultural counties declined \$827,000,000, or 56 per cent. The borrowings from the federal reserve banks by banks in agricultural counties increased \$128,000,000, or 565 per cent, borrowings by banks in semiagricultural counties remained practically stationary, and borrowings by banks in nonagricultural counties declined \$629,000,000, or 285 per cent.

It further appears from the same analysis that between the dates mentioned member banks showed a total reduction of loans amounting to \$882,000,000, of which \$827,000,000, or 94 per cent, is shown for banks in nonagricultural counties, while the reduction in agricultural and semiagricultural counties amounted to only about \$55,000,000. A subsequent analysis shows that during the year under consideration the share of agriculture in the total of outstanding loans did not diminish but, on the contrary, increased. The relative changes in the volume of accommodation to manufacturing and agricultural enterprises may be inferred from the following table.

Several factors need to be considered in examining this analysis. One is the fact that the dates represented in it do not show the extreme of the variations, for while the volume of loans was probably near the peak on the date selected in 1920, at the comparative date a year later the lowest point of bank-credit reduction had by no means been reached. It is also to be recalled that the unusually great carry-over of crops from the crop year of 1920, as well as various other exceptional circumstances, tended to make far greater demands than would otherwise have been felt.

Situation in 1920

All these facts, however, were not thus known and clearly recognized at the beginning of the so-called deflation period.

DISTRIBUTION OF MEMBER BANK LOANS, BY CHARACTER OF COUNTIES ON MARCH 4, 1920, AND APRIL 28, 1921
(Amounts in millions of dollars)

District	Loans of member banks in—				Percentage of total loans							
	Agricultural counties		Semiagricultural counties		Nonagricultural counties			1920			1921	
	1920	1921	1920	1921	1920	1921	Agricultural	Semi-agricultural	Non-agricultural	Agricultural	Semi-agricultural	Non-agricultural
Boston	\$35.2	\$34.5	\$21.3	\$22.9	\$1,332.0	\$1,295.9	\$2.5	\$1.6	\$95.9	\$2.6	\$1.7	\$95.7
New York	146.5	161.5	76.4	81.9	5,494.7	5,068.6	2.6	1.3	96.1	3.1	1.5	95.4
Philadelphia	87.2	96.8	33.2	34.7	1,003.7	975.9	7.8	3.0	89.2	8.8	3.1	88.1
Cleveland	162.5	160.8	367.8	375.3	1,062.2	1,163.0	10.2	23.1	66.7	9.5	22.1	68.4
Richmond	197.3	202.1	147.2	146.7	552.0	542.7	22.0	16.4	61.6	22.7	16.4	60.9
Atlanta	150.3	154.7	113.3	118.4	484.1	425.4	20.1	15.2	64.7	22.1	17.0	60.9
Dallas	360.0	337.2	106.5	104.2	237.4	207.5	51.1	15.2	33.7	52.0	16.0	32.0
Chicago	691.9	675.5	291.9	274.6	2,107.6	1,975.2	22.4	9.4	68.2	23.1	9.4	67.5
St. Louis	200.0	196.2	34.9	34.3	623.9	550.2	21.3	4.1	72.6	25.1	4.4	70.5
Minneapolis	395.2	376.0	76.3	71.6	338.5	297.8	48.8	9.4	41.6	50.4	9.6	40.0
Kansas City	406.7	353.8	87.0	78.0	564.9	489.5	38.4	8.3	53.3	38.4	8.5	53.1
San Francisco	357.3	404.5	128.3	122.8	990.3	972.6	24.2	8.7	67.1	27.0	8.2	64.8
Total	\$3,190.1	\$3,153.6	\$1,484.1	\$1,465.4	\$14,791.3	\$13,961.3	\$16.4	\$7.6	\$76.0	\$17.0	\$7.9	\$75.1

It was well understood that there had been tremendous speculation in the farming regions, that land had changed hands at tremendous speculative advances, that these advances had been reflected in the paper and the borrowing power of farmers at their local banks, and that in some measure the inflation had been reflected again in the portfolios of reserve banks. The Board and the system in general was perfectly conscious of the fact that it had no apologies to make with respect to the amount of farm credit granted in so far as volume was concerned. As already stated, the system was in no position greatly to expand its lines in any direction, but on the contrary, solvency and soundness called for a material reduction of them, although not specifically for a reduction of loans made to agriculture. Perhaps, therefore, the only fair policy that could have been adopted by the Board and by the system in general in these circumstances was that of treating agriculture exactly the same as every other branch of industry, making no discrimination against it or its loans, but, on the other hand, refusing to encourage the lending of funds to agricultural interests for the specific purpose of holding products over long periods of time or of increasing prices by establishing temporary monopolies in given kinds of output, or of indirectly assisting in speculative operations designed to maintain the values of lands.

While no detailed discussion was ever given to any of these aspects of the case, there was general recognition that the extension of loans for any of these purposes at a time when an effort was being made to eliminate inflation and speculation would be unfair and certainly not beneficial to the farmer. Perhaps the Board's policy in this whole matter was most clearly revealed in the attitude which it adopted with respect to loans designed to promote the holding of commodities in warehouse. At this time there was a very considerable amount of cotton, some of it rather poor quality, upon which loans had been obtained from banks and which had been --

ried for a long time in warehouse in the belief that still more fabulous prices for the staple would be realized. It was earnestly desired by cotton interests to prevent this cotton from getting into the market, and the same point of view was adopted by other interests representing large quantities of stored agricultural products. The matter came to something of an acute stage in certain of the agricultural districts and was brought before the Board in various forms.

The answer sent by Governor Harding to an inquiry of this sort may be accepted as fairly typical of the position which the Board, and through it the system, adopted with respect to agriculture.

The Federal Reserve Board has always advocated the policy of orderly marketing of crops. We realize that it is best for the producer, best for the consumer, best for the banking interests, and best for the railroads. Suppose an entire crop which takes the better part of a year to produce, a staple crop, should be dumped on the market in the course of two or three weeks or a month or two. The result would be that the pressure of the volume of that commodity, no matter how great the demand for it might be, on the market at one time would depress the price for it. It would tax the banks to furnish the money in advance of the consumptive need for the crop, and it would also tax the warehouse capacity, and the railroads would be burdened in furnishing transportation facilities.

Orderly marketing means some marketing, it means some buying and some selling, a gradual and steady process. I would regard as an ideal condition the steady movement of a staple crop extended over a period of five or six months, thus causing no strain on anybody and giving the producer the benefit of the average price.

Deflation a Misnomer

In later months when the Board fell under sharp attack in Congress, the term "deflation" or "deadly deflation" was constantly applied to the policy adopted during the years 1920-1921, but always in a strained manner involving gross misinterpretation of what was actually being done. It was implied that there was insistent and persistent effort to reduce

the amounts of loans going to agriculture and thereby to compel banks to restrict their accommodation to agricultural customers. As has just been shown, nothing of the kind was ever thought of or attempted, and when it is remembered that the Board's rates even at their highest were usually far below the rates actually charged to customers by member banks, the absurdity of the assertion is apparent. For instance, a bank in Nebraska which was in the habit of charging to its customers the legal rate in that city—10 per cent—was not particularly affected in its practice by an advance in the rate of rediscount at Kansas City, where its reserve bank was located, from, say, 5 to 7 per cent, or a reduction of like amount. It invariably charged the maximum legal rate or as near it as it could go, and its rate was always far above that charged by the reserve bank. The reserve bank had a far more effective means of control in the change of eligibility requirements but, as we have just seen, never applied these in such a way as to bring about any liquidation on the farmer but always permitted a retention of commodities on credit for the purpose of ordering the marketing, although it refused to support the idea of monopoly and of price-fixing. Such deflation as occurred then was the result of world-wide deflation, of the return of many men to agricultural pursuits in different countries, of the resulting demand for food for unproductive purposes, of the greater continuity in agriculture resulting from the wider application of machinery to it, and, above all, of the release of hoarded stocks which had been held back during the latter part of the war.

It is not to be denied that the result of these numerous causes was a very unfortunate and harsh influence upon the farm situation. Whereas skilled labor succeeded in maintaining itself at abnormally high wages, farming labor found itself early obliged to return to something like the pre-war normal. Whereas price-fixing agreements among manufacturers succeeded in holding up the values of machinery, barbed wire,

GROUP INDEX NUMBERS—UNITED STATES—BUREAU OF LABOR STATISTICS
(1913=100)

Date	Farm products	Food etc	Clothes and clothing	Fuel and lighting	Metals and metal products	Lumber and building material	Chemicals and drugs	House furnishing goods	Miscellaneous	All commodities
1913	100	100	100	100	100	100	100	100	100	100
1914	103	103	98	96	87	97	101	99	99	100
1915	105	104	100	93	97	94	114	99	99	101
1916	122	126	128	119	148	101	159	115	120	124
1917	189	176	181	175	208	124	198	144	155	170
1918	220	189	239	163	181	151	221	196	193	196
1919	234	210	261	173	161	192	179	236	217	212
1920	218	239	302	238	186	308	210	366	236	243
August 1920	222	235	299	208	193	328	216	363	240	250
1921										
January	136	162	208	228	152	239	182	283	190	177
February	129	150	198	218	146	221	178	277	180	167
March	125	150	192	207	139	208	171	275	167	162
April	115	141	186	199	138	203	168	274	154	154
May	117	133	181	194	138	202	166	262	151	151
June	113	132	180	187	132	202	166	250	150	148
July	115	134	179	184	125	200	163	235	149	148
August	118	132	179	182	120	198	161	230	147	152

fertilizer, and various other things that the farmer needed, he found his own price for staples getting well back toward pre-war value, while the manufacturer, although suffering severely, was not obliged to go nearly so low down in the scale as he was. The tabular showing on page 1477 of index numbers made by the Bureau of Labor Statistics for different groups of commodities will illustrate this situation.

As thus shown, the condition to which the farmer was subjected was severe but in no respect the outcome of banking or credit manipulation. That such was the case must be plainly inferred from the fact that for at least eight months after the sharp decline of agricultural prices began in May, 1920, the volume of loans in the aggregate extended by the reserve banks and by their members showed no decline. In fact, it was not until the end of 1920 that the peak in reserve bank accommodation was reached. If mere credit could have represented the situation particularly, we may say with confidence that the reserve system did all that it could to alleviate or neutralize the effects of what popularly came to be called deflation.

Popular Movement Against Reserve System

These facts, however, were not recognized, and but little was done to bring them to the attention of the public either by the Board or by anyone else. In the autumn of 1920 the country again plunged into another presidential election during which hasty promises were made on both sides concerning the farmer, while charges were flung about rather recklessly concerning alleged misdeeds on the part of the banking and credit managers of the country. Particular attack was directed against the discount rate structure of the federal reserve system which, it was assumed by politicians, represented substantially the rates that were being charged to actual borrowers. The campaign, although based upon platforms which as usual gave no distinct promises concerning banking policy and

were as obscure and evasive as their authors could well make them, nevertheless had resulted in fairly definite commitments on both sides of the struggle to do whatever was necessary to bring about a rectification of price, commodity, banking, and credit conditions

Thus when the Harding administration entered upon office on March 4, 1921, it found itself with a very considerable liability in the form of these pledges. What it could do and how it could fulfil the promises thus made became a serious problem, but one which must be considered more broadly than in its mere relation to agriculture, notwithstanding that agriculture soon came to play a foremost part in the discussion of the situation. The general discount rate policy of the system may, however, be deferred for the moment. Whatever was done it was not done promptly enough, or effectively enough, or with sufficient explanation to convince the public mind that the reserve system was not, as the politicians had painted it, responsible for most of the evils through which the community was passing during the period of reaction. In Congress particularly, the popular hatred of the so-called banking interests became very obvious during the summer of 1921. This condition of things was aggravated by the machinations of politicians who had been eliminated from office with the retirement of the Wilson administration and who now sought to show that the reserve system was not functioning as they would have had it.

One outcome of the sporadic discussion and dissatisfaction thus referred to was seen in the appointment of the Agricultural Commission of Inquiry in the summer of 1921. This Commission held elaborate hearings and heard many of the criticisms and defenses of the reserve system. In particular it made a lengthy investigation, and although presumably starting with some bias against the reserve system, ended by giving it a reasonably clean bill of health. Its findings with respect to the amount of credit extended have already been

cited at an earlier point, and its general attitude toward the Federal Reserve Board and the system at large were summed up in the excerpt from the report already quoted, which may be taken as indicating a belief that perhaps too much credit had been given to the farmer rather than too little, and that the fault if any lay rather in the slow and belated change of policy than in erroneous decisions, or in the psychological effect of the policy pursued. As the Commission says ⁴

It seems probable that a change in the policy of the federal reserve system with reference to discount rates would have accomplished a reversal in part of the psychological and economic factors which at this time were moving in the direction of lower prices, and at the same time would have tended to induce on the part of banks a more liberal attitude of furnishing additional credit.

A policy of lower discount rates at this period of liquidation of stock and decline of prices must necessarily contemplate that the policy will be made effective in a more liberal policy in the extension of loans. From a banking point of view, the desirability of a liberal policy in the extension of loans must depend upon the supply of funds available for this purpose. That is to say, a bank can lend freely only when its condition is such that it can do so without endangering the interests of its depositors and its stockholders.

Therefore, in order to ascertain whether a more liberal policy on the part of the banks of the country generally was desirable in the latter months of 1920, recourse must be had to the condition of the banks at that time. This condition varied very widely. In general, one-third of the banks were very greatly extended, about one-third were moderately extended, and the other one-third were lending within very conservative limits. This condition was indicated by the number of member banks borrowing from the federal reserve system, about one-third were borrowing very heavily, one-third were borrowing moderately, and one-third were not borrowing at all. Obviously, the one-third that were not borrowing at all could borrow from the federal reserve banks to meet their requirements without difficulty, the one-third that were borrowing moderately could borrow additional funds, and the third that were greatly extended and were, therefore, the more heavily pressed by their customers for additional loans, could not

⁴ Report op cit, p. 87

borrow in order to extend still further credit without endangering their own solvency

The Outcome in Legislation

The eventual outcome in legislation of this whole episode was seen during the session of 1922-1923, when extensive bills providing for a new system of rural credit were introduced, given perfunctory and incompetent debate, and eventually passed. The whole question of rural credits legislation had been actively taken up by Congress for consideration during the session of 1921-1922 but no definite results were realized. The postponement was not due to indisposition to act but to uncertainty as to the best method of procedure. President Harding in his opening address at the short session of Congress which began in December, 1922, strongly urged the consideration of the rural credits question, pointing out the need of intermediate financing of the farmer's requirements. By intermediate financing was meant the financing of agricultural operations running from one to three years and involving such undertakings as the fattening of live-stock and probably the planting of crops such as fruit which required some time to bring them well toward maturity. Three principal bills made their appearance during the session, the first designated as the Capper bill because introduced by Senator Capper of Kansas, the second the so-called Lenroot bill offered by Senator Lenroot of Wisconsin, and the third the so-called Strong bill offered by Mr. Strong of Kansas and designed to provide for changes in the conditions of loaning at federal land banks. These bills were individually adopted by the Senate and were then combined by the House of Representatives into a consolidated general measure which provided for the following principal points

1. The creation of twelve institutions to be known as "federal intermediate credit banks" such banks to be established in the same cities as the land banks and to be operated

- by the officers and directors of the land banks, thus becoming really departments of the land banks
- 2 The establishment of national agricultural credit corporations to be formed by subscriptions to capital stock furnished by individuals
 - 3 The creation of rediscount corporations whose function it would be to discount paper brought to them by the national agricultural corporations or by others who might be able to present eligible paper
 - 4 The modification of the Federal Farm Loan Act so as to permit an increase in the amount of loans to any one borrower up to \$25,000, as well as to provide for a more representative type of control of the boards of directors of federal land banks
 - 5 The modification of the Federal Reserve Act so as to permit reserve banks to discount paper and buy debentures offered to them by the new agricultural institutions Further provision was made for the admission of smaller banks as members of the federal reserve system, and farm paper of nine months' maturity was made eligible
 - 6 The extension of the life of the War Finance Corporation up to and including February 29, 1924
 - 7 The establishment of a Congressional Commission of Investigation to look into the entire banking system and to ascertain reasons why the smaller banks in the country districts have not more generally become members of the federal reserve system

Purpose of New Law

These are only the outstanding facts in a lengthy measure of legislation detailed in character and introducing many far-reaching changes into the existing banking structure In a general way, however, the purpose of the act in question is sufficiently plain It was intended to provide for the extension of credit in a field which had previously been largely without the scope either of the federal reserve banks or of federal land

banks Federal land banks have not been able to do this kind of lending because of the fact that they were by the terms of the Farm Loan Act limited in their operations to actual mortgages on farm land which in ordinary circumstances would run for a very much longer period and would be given for the purpose of buying or improving a farm with the intent of liquidating the loan out of earnings Such transactions were entirely outside the scope of the federal reserve banks because such banks were limited in the maturity of their paper to six months and because of the fact that they had to maintain themselves in a highly liquid condition and were at no time in position to "tie up" very much of their resources in this long-term type of advances Thus, as explained in former pages, the farmer who desired to get credit for a rather long-term productive operation had in the past been obliged to resort to finance companies of various kinds, or to employ unsatisfactory plans of mortgaging his farm, in order to obtain the working capital for an actual productive operation Under the terms of the new law a special type of business was provided for, the agricultural corporations referred to being authorized to engage in the business of financing these long-term undertakings while at the same time some similar powers were vested in the new departments of the land banks

The new act was almost inconceivably crude and dangerous, providing for immense issues of tax-free securities, and opening the doors of reserve banks to volumes of long-term "frozen" paper The hazard of it was at once apparent, but the measure was already a law

CHAPTER LXVII

BANKING AND POLITICS

New Administration

As has been seen in earlier chapters, a Republican administration had come into office in the spring of 1920 after a campaign which involved some extensive pledges concerning the management of the credit situation. Among the first acts of the new administration was the utterance of positive statements and predictions that the level of discount rates would very soon be lowered. Good business was predicted. The revision of the tariff was taken in hand at once and an early end to the ills of the farmer was forecast. However, a good deal more remained to be done before any real improvements would be likely to occur in the industrial situation. An emergency tariff imposing heavy duties on agricultural products was promptly passed and arrangements were made for reviving the War Finance Corporation which Secretary Houston had brought practically to a standstill. It was intended by the use of this agency to finance foreign trade more extensively, but primarily to help the farmer. Exactly how to reach the Federal Reserve Board was, of course, a more difficult question, although the administration had already two representatives upon it—the Secretary of the Treasury and the Comptroller of the Currency. At first the principal method of impressing the Board with the wishes of the new authorities was the indirect one of statements and predictions and of holding informal conversations with members in which effort was made to impress upon the latter the thought that rates ought to be reduced.

Policy of Board

As a matter of fact, the question of discount rates had been under sharp discussion since about the beginning of 1921. Some members of the Board were doubtless impressed by the expressions of public opinion in the campaign, others were naturally inclined toward reductions of rates and believed that the high level of charges already established had lasted long enough. Still others probably thought that the new administration would force rates down in any event and that it might be as well to act without delay and to forestall an embarrassing situation. In any event a decision had been reached to cut discount rates and this policy was initiated very soon after the advent of the Harding administration, the first reductions being announced in May, 1921. They were followed by still others, with the result that by autumn of the same year discount rates had reached a low level of practically 4 to $4\frac{1}{2}$ per cent, the former being the rate charged by the Boston, New York, and San Francisco banks, while the $4\frac{1}{2}$ per cent rate was in vogue at the other institutions.

This low level of rates was immediately announced by members of the administration as the outgrowth of their own influence, and in the congressional campaign of 1921 such a claim was baldly made by some of the higher officers who asserted both the credit for the reduction of the discount rates and the belief that such reductions had resulted in prosperity. Appeal was thus baldly made to the electorate to cast votes in favor of the controlling political party, because of action which it represented itself to have taken in reducing discount rates at federal reserve banks. These representations did not, as a matter of fact, appeal to the voters, perhaps because in the meantime the great recession in prices had largely decreased the demand for credit so that member banks throughout the country were amply able to meet all probable demands from their customers without rediscounting. During the year 1922, the portfolios of the reserve banks reached a low point, 'not

far from \$500,000,000, the great city banks having practically withdrawn as rediscounters, while even in the country the process of liquidating frozen loans had proceeded rapidly. In some measure this process was accelerated by the action of the War Finance Corporation which during the year advanced about \$430,000,000, a considerable part of that sum being used to take up paper held by city correspondents of country banks, with the result that bankers of all kinds were able to reduce their borrowings at reserve banks.

Thus the government practically stepped in to relieve the agricultural public of the necessity of meeting its obligations at reserve banks. It of course drew upon reserve banks for money with which to finance War Finance Corporation activities, and in this way it applied a political method of banking for the purpose of securing the long extension of paper which had originally been taken upon the assurance of payment at maturity. The demoralizing effect of such transactions can hardly be overestimated, and speedily made itself apparent in the changed attitude of the financial community with respect to the whole question of reserve banking.

Membership of Board

Undoubtedly the administration was dissatisfied with the membership of the Board. There had always been a feeling that it was "Democratic" in its sympathies, and although Secretary Glass had recommended the appointment of Chairman Edmund Platt of the Banking and Currency Committee, the President acting on this nomination and later naming Mr. Platt Vice-Governor, it was still felt that not enough had been done to Republicanize the organization. During the latter part of the Wilson administration, a vacancy had existed in the Board which had been temporarily filled by the appointment of Federal Reserve Agent Wills, the Chairman of the Cleveland Reserve Bank, who had been drafted into the service with the understanding that he was to go back to his bank at

the end of his administration Mr Wills had succeeded F W Moehlenpah, who had been nominated by Secretary Glass at the instance of former Secretary McAdoo to fill out an unexpired term caused by the withdrawal of F A Delano. Secretary Houston refused to recommend his reappointment, Mr Wills being (as already explained) drafted in his place. When Mr Wills withdrew on the 4th of March, one of the first steps of President Harding was to appoint Mr J R Mitchell of Minneapolis, a Republican and a banker of that city, who was promptly confirmed. It was desired, however, to obtain control of the Governorship of the Board as soon as the term of the incumbent—Governor Harding—should expire. Unofficial statements and interviews given out by members of the administration very early indicated that Mr Harding would not have much chance of reappointment.

Attack by Democrats

While conditions were in this state a bitter attack upon the Board, and on Governor Harding particularly, was launched in Congress. A good deal of the material for it was supplied, as was afterward testified on the floor, by the former Comptroller of the Currency, J S Williams, who had gone out of office on March 4 owing to the fact that the Senate had never been willing to confirm him, so that his term ended at the same time with that of Mr Wilson. Williams was unfriendly to Governor Harding and to the Board generally and, working in conjunction with a number of Democratic senators, he began to attack the policies for which he himself as a member of the Board at the time had been jointly responsible. Among these were the appropriations for bank buildings, the salaries of bank officers, the discount policy, and a variety of others. The attack appeared in the form of various resolutions calling for investigation of the Board or its members and in speeches of general abuse and attack. These speeches, which would ordinarily have been answered on the floor, were about

to pass unheeded on the theory that they originated with Democrats and were directed against Democrats. Demands (originating with the Board) for investigation by some official body were unheeded, but eventually it became desirable to meet the desires of the farmer by creating a commission of inquiry into the system.

A congressional commission was established vested with the power to inquire into the policies of the Reserve Board and of the several banks. The investigations of this body lasted throughout the summer of 1921 and eventually gave rise to a report filed early in 1922, whose general tenor has already been reviewed at an earlier point. The report added nothing to what was already well known, the principal facts as to the Board's operations having been regularly published by it. The commission's report, however, was unexpectedly favorable to the Board and hence disappointed those who had expected to find in it a basis for removals or for drastic action of some kind. Accordingly the attack was continued from the floor without definite charges but simply on the basis of personal abuse without the submission of evidence in any form. Resolutions of inquiry from time to time as to expenditures and other policies were adopted by the Senate and duly answered by the Board, but no new light upon the working of the system was afforded. Perhaps the only important outcome of the campaign was to serve as a means of displaying general hostility toward Governor Harding.

Political Appointments

Meantime, however, it had been desired to obtain some of the loaves and fishes for political retainers, and recommendations had been made by politicians to the Board with that in mind. These recommendations had received no notice and practically all recognition of political applicants was refused. The outcome was to refuse a renomination to Governor Harding. Since he never had had any effective support in the

Senate, nor had found a disposition to sustain him in the White House, it had become apparent by the beginning of 1922 that his chances for continuation in office were small or non-existent. Nevertheless considerable doubt concerning the renomination of Governor Harding continued to prevail, due to the fact that the banking community began to manifest a strong desire that his services should be recognized fully through a renomination. This position on the part of the bankers and financiers was strongly expressed in letters and resolutions expressive of the views of various associations and organizations as well as of individuals. As the year 1922 advanced it became evident that the President could not refuse a renomination to Governor Harding without seriously exposing himself to the charge of political prejudice or of mismanagement of the banking system, since the attack upon Mr. Harding originated primarily with politicians who for one reason or another had developed personal grudges or were representative of elements in the community that felt themselves aggrieved because of a lack of credit in the proportion that they desired. These facts in the situation caused President Harding to review the problem of the organization of the Board with considerable care.

Meanwhile, however, Congress had further amended the Federal Reserve Act by providing for an additional member of the Board who, it was understood, should be a representative of practical agricultural interests. The President thus by midsummer had before him the problem of naming two new members for confirmation by the Senate, while he had also the problem of selecting either one of the new or one of the older members as Governor of the Board. The action of Congress was taken largely as a concession to what had come to be known as the "farm bloc," which practically represented the selfish interests that centered about farming on a large scale or had to do with the dealing and trading in agricultural com-

modities This farm bloc had attained extraordinary power in Congress during the year 1921, and the effort to placate it practically prohibited any strenuous resistance to the notion of giving it a special representation on the Federal Reserve Board President Harding, too, had previously appointed a personal friend, Mr D R Crissinger, as Comptroller of the Currency, and he had assumed office soon after the entry of the Harding administration upon its duties The President eventually determined to transfer Mr Crissinger, who was ex-officio a member of the Board, to regular membership in that organization, at the same time undertaking to name him as Governor, while he selected Mr M D Campbell, the head of a Michigan Milk Producers' Association, as the farmer member of the Board To these he added the name of Mr James B McNary, of New Mexico, as Comptroller of the Currency Prior to the ending of Congress on March 4, 1923, the first two of these names had been confirmed but the Senate declined favorable action upon the latter owing to dissatisfaction with Mr McNary's banking record As Mr Crissinger was already Comptroller of the Currency, the inability to secure a successor (Mr McNary having on March 5 refused to take office on a recess appointment) necessitated Mr Crissinger's continuing the retention of his office still longer ¹

Thus the Board which had been without a Governor subsequent to August 10, 1922, the date when Mr Harding's term of office had expired, continued up to March 4, 1923, and for a time thereafter without a new Governor and with gaps in its membership resulting in consequent disorganization. Undoubtedly these appointments and the method of making them struck a very severe blow at the prestige of the system and particularly of the Board, since they clearly revealed the entry of political considerations of a controlling character in the selection of personnel

¹ On April 25 the resignation of J R Mitchell from his membership was also, unofficially, announced

Influence in Minor Appointments

In this same connection it soon became evident that the politicians were casting greedy eyes toward the minor appointments in the reserve system. Highly placed members of the party had not hesitated to promise directorships and chairmanships of federal reserve banks to political hangers-on or contributors to campaign funds. Not long after the Harding administration took office, a "drive" to secure some of the places set in, though it should be added that the Board itself usually turned a deaf ear to such solicitations. Senators and representatives began to visit the Board in increasing numbers with a view to securing preferment for their favorites in the several districts, and the opinion prevailed widely among Congressmen that it would not be long before the system would be at their mercy in the matter of "patronage." This opinion was, of course, in large measure stimulated or based upon the attitude of the President himself in regard to the membership of the Board, and necessarily produced a demoralizing influence as it gradually became known throughout the entire system. At the close of the spring of 1923, it was still uncertain how far the system would be able to resist the pressure for political appointments which had thus begun to manifest itself in the various ways to which reference has already been made.

Effect of Attack

It was not at all strange that the apparent unfriendliness of the administration and the constant and persistent attack in Congress, unopposed as the latter was by any strong or positive effort of support or vindication, should tend to break down the morale of the Federal Reserve Board and, of course, of the system itself. It is seldom if ever possible for any administrative organization to endure a continuous fire of attack and abuse to which it is not able to reply, without losing a portion of its independence and courage. This is

not a reflection upon those who are affected by such conditions, it is merely a statement that they are subject to the same limitations as are all human beings. The Federal Reserve Board, it will be remembered, had asked at an early date for a thorough congressional investigation but its request had been ignored or refused, and it had had nothing except the left-handed vindication which was incidentally and reluctantly accorded to it by the Joint Commission of Agricultural Inquiry which reported in 1922. It was, therefore, not unnatural that the membership of the organization should feel the constant and severe pressure to which it was being subjected through the congressional attack already described, and that the question should arise in many of the reserve banks as to how far they would be able to preserve their integrity.

Already the banks had begun losing efficient employees. There had been a natural and proper attempt to cut down expenses subsequent to the close of the war period, in order that the staff and general outlay involved might correspond more closely to the reduced volume of business of the banks. The system, however, demonstrated no new capacity to take on functions or new business, and the fact that the volume of its transactions was naturally declining during 1922 produced the reflex influence upon its membership that is automatically exerted by such conditions in nearly every case. Undoubtedly, therefore, the year 1922 must be reckoned as one of decadence, although such decadence can hardly be ascribed to any direct fault on the part of the management of the system or of the banks.

Political Efforts of Bankers

Members of the banking community were themselves in many cases not above the use of political intrigue for the purpose of attaining their own objects. The country banks of the South had early organized for the purpose of resisting the enforcement of the par collection system. During the year 1920

they had become convinced that an appeal to Congress was not likely to be of much service and they had consequently begun local political attack by inducing the legislatures of southern states to adopt measures directed against par collection. Eight legislatures yielded to such representations and enacted measures which rendered it difficult or impossible for the par collection system to work satisfactorily among the state banks. The same bankers, moreover, organized a national committee and set to work to bring about action by Congress designed to cut off par collection entirely.

One indirect result of this was the incorporation into the Rural Credits Act passed on March 3, 1923, of a provision calling for an elaborate inquiry into the doings of federal reserve banks and of the Federal Reserve Board in their relations with member banks. At the same time suits were pressed in federal and state courts in the South, Middle West, and Northwest for the purpose of attacking the par collection system, and in a number of cases favorable or neutral results were obtained through judicial decisions directed in some cases at what appeared to be genuine abuses of the power of reserve banks in the enforcement of par collection. Thus from many angles the banking community, especially the so-called country bankers, joined with the politicians in attacking the reserve system and in endeavoring to undermine its strength at every possible point.

Jealousy in Foreign Negotiations

The post-war developments in Europe had for a long time clearly pointed toward the necessity of some action which would assist in restoring the convertibility of European currency and the restoration of European banks to solvency. These were purposes, however, which could not be attained without the direct co-operation of the federal reserve system, and the Board therefore early began to devote considerable attention to a study of foreign conditions. It occasionally

announced tentative opinions with regard to the foreign situation in its Bulletin or in other publications, but the Harding administration had not been in office long before it was made apparent that any such effort to provide constructive investigation or to suggest a definite plan for use in connection with European rehabilitation was distasteful to those in charge at Washington. Eventually, therefore, it was found necessary to discontinue all such investigation or discussion, and during the tentative negotiations of the summer of 1922, when it seemed as if some joint international plan might be evolved looking to the co-operation of the United States in restoration of banking and solvency in Europe, the system was wholly without power to undertake or carry on any negotiations or to obligate itself in any way in connection with gold exports or with the undertaking of new commitments through negotiations with foreign banks.

In its possible foreign activities as well as its domestic, and worst of all in connection with its appointments, the organization thus found itself subjected to control, direction, oversight, criticism, and complaint. It is this situation which is ordinarily contemplated by those who are familiar with conditions in Washington and which has been usually referred to as the introduction of "politics" into the federal reserve system. The development of such politics was not the product of any one decision or determination, or the outcome of the act of any one person. It was the product of a political atmosphere in which the growth of noxious germs injurious to sound banking was encouraged while the application of remedial measures was discouraged or prevented.

CHAPTER LXVIII¹

THE SYSTEM—RETROSPECT AND PROSPECT

Basis of Judgment

A period of eight years would not ordinarily be sufficient to furnish the basis for a conclusive judgment of any new banking organization established on a national scale. The First and Second Banks of the United States were both granted twenty-year charters. In neither did the issues which finally led to the refusal of an extension become well defined until much more than the first half of their life had expired. Nor was it possible, even at that time, to form a sound judgment of the effects which these institutions had produced. A review of the history of the Bank of England, and of that of the Bank of France, enforces the conviction that many years must elapse in the life of a highly organized community before conclusive and final judgment can be formed as regards the essential effects of a new banking system. Particularly must this be true in the United States, because of the fact that the federal reserve system was grafted upon a parent stem, and was not a new implantation. In these circumstances, an even longer time must necessarily be allowed to pass before the modifying influence of a new and vast financial organization, making itself completely felt, affords a basis for judgment.

Far-Reaching Changes

During the past eight years, the federal reserve system, in common with other banking organizations, has lived through a succession of changes such as otherwise might not have been

¹In preparing this chapter large use was made of an article by the author in *Political Science Quarterly*, December, 1922.

encountered in the course of a century. It has compressed into a short space many varieties of experience and, in a measure at least, has been able to profit by them, though not of course in the degree that would have been realized had these experiences been spread over a longer period. It is, at all events, a fact that a turning point in the history of the federal reserve system has now been reached, and that within the next year or two, probably, conclusions will be arrived at which will in an important degree condition the future development and service of the new banking system. The period of war finance, so far as the federal reserve system is most materially concerned, has been brought practically to a close, and the question how the system can be fitted into a normal environment is now uppermost.

The Mechanism

First and foremost among the questions which presented themselves as matters of doubt at the inauguration of the system, was the problem whether the mere mechanism or technical equipment which had been prepared, could be esteemed satisfactory. The doubts which were first entertained by those who opposed the enactment of the Federal Reserve Act related to the question whether a system composed of twelve independent units could be made to operate harmoniously, and whether the control of the system exerted through the Federal Reserve Board at Washington as a co-ordinating agency could be made to succeed. The doubt that was felt by many more or less unprejudiced observers related not merely to the question of the choice of personnel, but raised also the issue whether, with the very best personnel, the mechanism that had been established could attain its ends.

It will not be denied that this mechanism has certainly been subjected to a very severe strain during the past eight years, and it will probably be conceded by most that the machinery has resisted this strain unexpectedly well. There has been little in

the way of scandal or objectionable conduct at any reserve bank or branch bank. So far as is known, no financial irregularities have even been suspected. Apparently also, the management of the several banks has been at least reasonably efficient, and, in spite of congressional statements to the contrary, not more expensive than the machinery of the member banks in each district. Nepotism and personal favoritism, which were jealously kept out of the reserve banks at the outset, have occasionally invaded some one or more of the units of the system, but probably in no higher degree, if as high, than is true of many of the member banks. The question whether a central reserve bank can be better than its members, or a government on the average better than the rank and file of the people, is one of perennial interest. There is good authority for the belief that neither of these conditions can very long be realized. At all events, the federal reserve banking system has undoubtedly been as well organized, as efficient, and as little expensive as the typical American bank. This perhaps is not the highest of encomiums, but it is certainly far higher praise than can be accorded to any purely governmental organization of recent times in the United States.

In the main, the system of branches established by the federal banks has proved at least reasonably efficient. Such elements of inefficiency as have been noted will probably be gradually improved, for the theoretical basis of the branch system is, on the whole, sound. So, taken all in all, it may be said that the operating mechanism of the federal reserve system, in spite of some elements of friction and with many unsatisfactory features, has commended itself to the thoughtful student and has shown its entire adequacy to the solution of the problems before it.

The Board

As for the Federal Reserve Board, the controlling mechanism of the system, it has from the start been superior in

efficiency and sincerity to most similar government bodies. The appointing power had in the beginning decreed that it should not be a group of great men, but it has certainly consisted of men who have in the main done their utmost and have worked single-mindedly with an eye to success of the enterprise. They have succeeded in conducting a great banking system upon a basis of working efficiency, justice, and moderate expense. So far as their own organization is concerned, it has probably been, all things considered, the least expensive organization of any similar kind that the government has had under its charge. As to the policy of the Federal Reserve Board in the general operations of the system, more will be said at a later point. At this point, it is enough to note that the policy of the Board has usually been the best financial policy at the command of the government, it has almost invariably been superior to that of the management of the Treasury Department and, as already stated, has been carried out with an eye single to the success and welfare of the enterprise, and of the nation.

Undoubtedly experience has demonstrated that the present method of constituting the Federal Reserve Board is unsatisfactory. It has fallen constantly under the supervision of politicians, and even when not under their influence has been constantly fearful that it would be obliged to yield to them. The fact that it has not yielded in the matter of appointments is greatly to its credit but represents a condition which probably cannot be very long maintained. All this means that the present position of the Federal Reserve Board is not one which can be regarded as permanent if our banking system is to function in safety. The question seriously raised is whether something like the plan at first proposed in the federal reserve act, whereby the bankers themselves would have been given a partial representation on the Board, may not have to be introduced, or whether, if public opinion should continue adverse to such an arrangement, it will be possible to obtain a composi-

tion of the Board which shall be far less influenced by political considerations than at present

One or two minor suggestions that have been widely made and widely accepted are worthy of mention. One of these is the merging of the powers of the Comptroller of the Currency with those of the Board, a step proposed in the original Federal Reserve Act and whose wisdom is overwhelmingly apparent. A second is the elimination of the Secretary of the Treasury from membership in the Board or, at all events, a change in his relation to the organization. A third is the entire removal of the Board and its offices from the Treasury Department and of a definite recognition that it constitutes, as the Attorney-General described it, an independent bureau or establishment.

But these minor changes can hardly be expected to suffice. Something very much more far-reaching is indispensably necessary and that something can be only a thorough and effective change in the present methods of appointment. Whether this shall come through the prescription of qualifications for membership or whether it shall come through a gradual raising of the standards by successive presidents, or whether it shall be the result of some new system of choice whereby the banking and financial community will be given a share in the work, remains to be seen. Each of these methods has its faults and is either so slow and uncertain as to make it undesirable, or so defective in vital principles as to make its efficacy questionable. The subject demands early and careful attention with a view to rescuing the Reserve Board from the status of a dependent routine administrative body largely subject to the political attack and influence into which it appears to be falling. If it can be restored to its normal functions, many other requirements will almost automatically ensue, among them being the definite establishment of the Board's power over reserve bank operations in the particulars specified by the constituent act, the restriction of the overgrowth of some of the units of the

system, notably the New York bank, and the gradual development and improvement of sundry of the weaker institutions

Relation with Government

Passing from the basic question of mere technical efficiency, it is next necessary to confront a problem frequently mentioned at the time of the inauguration of the federal reserve system, as to which the utmost pessimism was expressed and in which no small part of the doubt and hesitation then felt has been shown to be warranted. This second question has to do with relations between the government of the United States and the federal reserve system.

The essential question at issue in this connection was from the beginning whether "political influence" could be excluded from the management of the system. This is at best a somewhat vague and loose way of expressing the question uppermost in many minds and calls for a more exact definition of the term "political influence." Many of those who had feared political influence in the past had apparently taken it for granted that that term implied the use of personal influence in the making of actual loans. There has never been the slightest reason to suppose that in individual matters of this sort any effort to influence the Federal Reserve Board was ever brought to bear upon it or upon the several banks in the hope of shaping action. In the broader sense, however, the term "political influence" may be used as indicating an effort to shape policies either in the interests of given classes, or in the interests of methods which it was supposed would work more or less directly to bring about "prosperity" or conditions favorable to particular kinds of business. Viewing the term "political influence" from this standpoint, it must be admitted without qualification that the system has never been free of assaults of the kind referred to.

The thought of those who have urged concessions in dis-

count rates has no doubt been that the particular interests which they represented were so closely identified with the national welfare as to warrant the adoption of every kind of pressure with a view to securing exceptionally favorable treatment for them. Such an attitude is, of course, wholly foreign to the concept of a scientific banking system, and is undoubtedly to be classed as an exemplification of that "political influence" which has been so greatly feared in times past. Should such efforts be continued and extended, as there is reason to fear that they may be, the result might easily be the adoption of policies which would result in serious unsoundness in the banking system, and might operate largely to vitiate the entire structure of finance upon which it is founded. Coupled with amendments to the underlying statute itself, whose purpose it is to secure eligibility for long-term or non-liquid types of paper, this type of influence undoubtedly must be viewed as a danger of first magnitude—one which the federal reserve system has in nowise been able to avoid and which threatens its very existence.

It is fair to ask at this point whether a central reserve bank of the type which was often advocated before the adoption of the Federal Reserve Act would have been able to avoid this danger in a greater measure. Past experience does not indicate that such would have been the case, nor is there much in contemporary European experience to warrant any such belief. There are some factors in current political life indeed, which suggest that such an institution might have been the target for even more serious attack and that its work might have been vitiated in even greater degree than that of the federal reserve system. This is a matter of opinion or of conjecture. The fact remains that the federal reserve system has not been successful in avoiding the danger of "politics" as applied to its workings in the broadest sense, and at present has no prospect of such success.

Salaries

As was almost unavoidable, a great deal of discussion about federal reserve system has centered upon unessentials. One such unessential matter has been found in the question whether individuals were or were not receiving unduly high salaries. Congress has devoted to this question an infinite amount of discussion which might well have been given to more serious subjects. The federal reserve system had at the close of 1921 about 12,500 employees, and its annual expense of operation ran well up toward \$36,000,000 in 1921. It is not likely that any such sum of money was ever expended by any human institution without some waste. Neither is it probable that any such expenditure has ever taken place without the presence of some nepotism or favoritism on the part of sundry of those who are charged with financial responsibility. To assert that there has never been any waste in the federal reserve banks either as to buildings or personnel would, therefore, be going a long way. The main facts in the case, however, are sufficiently clear.

Careful statistical comparisons made between the salaries paid by federal reserve banks and those paid by surrounding member banks in the several districts have shown that with but one exception—Richmond—these average salaries are distinctly below those paid by the larger member banks of the locality. If comparison be made on the basis of overhead expense per unit of business done, the comparison between the reserve banks and the neighboring member banks would be still more favorable to the former. It should, however, be noted that comparisons of this kind are probably not altogether fair. In European countries the contrast between central bank salaries and salaries paid by commercial banks is a striking one. The salaries of the managers of central banks are based upon the theory that the service is in a large measure a matter of public duty, and that compensation is to be based mainly upon the standard prevailing in public employment rather than

upon that allowed by the highest grade of private employment. We have not developed any such standard of public service or public duty in the United States, and if we are to buy the services of men of good standing in the financial and banking world at a rate which is commensurate with that which would be offered by commercial banks, it may be doubted whether the scale of salaries will ever be much lower than it is today.

A careful investigation made by the Division of Analysis and Research of the Federal Reserve Board into the salaries paid by reserve banks to all employees receiving less than \$5,000 per annum, showed that these employees were, on the whole, paid rather less than corresponding employees of member banks and that in many instances they did not receive what could fairly be called a living wage. It would seem, therefore, that, with the exception of cases of nepotism or favoritism, the general expenses of the federal reserve banks have been kept to a commercial basis and that the government has paid for the work about what would have been paid by commercial banking institutions.

Buildings

As for the building program of the reserve banks of which so much has likewise been said in Congress, final judgment will depend upon the opinion which is formed regarding the necessity of such a building program. It is doubtless true that the program of the reserve banks as now in process of being carried out, has been gauged by necessities which were developed when post-war activity was at its peak. This activity has vastly fallen off and the building equipment of most of the banks is undoubtedly ahead of their real needs. Bearing in mind, however, that they have taken over extensive Treasury functions and that other functions have been quite steadily transferred to them by Congress, the conclusion will doubtless be reached that the answer to the question whether a building

program on the scale proposed was needed or not is a two-sided one. On the other hand, it is true in connection with buildings as in connection with salaries, that where large sums of money are spent the elimination of favoritism is difficult and that the existence of isolated cases of such favoritism or extravagance is highly probable. This does not condemn the program as a whole, for an investigation of it seems to show that there is no reason to suppose that it has been more expensive either in the aggregate or per unit than a similar program carried out by others would have been.


The real judgment of the case, as already stated, must depend upon the opinion to be formed as to the necessity of any such program. That it is ahead of immediate needs may readily be conceded without necessarily subjecting it to unduly severe criticism. That there have been instances of extravagant outlay in connection with individual banking aspects for which provision was being made, need not be questioned. All of this has but little to do with the general question of propriety and expense involved in the matter. The point at which congressional critics have been most prone to direct their attack is found in the fact that all surplus earnings of reserve banks over and above 6 per cent on the stock of members are to be paid to the government as a franchise tax. Any alleged extravagance in salary or in building is thus referred to as a kind of theft from the pockets of the people—a use of money which did not properly belong to the various institutions. For this point of view there is, of course, no warrant whatever.

Returns to Public

The federal reserve banks have paid to the government in the course of their existence franchise taxes far in excess of those paid by foreign central banks and amply sufficient to represent an adequate tax on the system designed to compensate for what was practically a monopoly privilege of note issue. They have, moreover, performed services of the highest

value without charge to the government in connection with the transfer of funds and the performance of fiscal functions. What the exact cash value of these services is cannot be precisely stated, but it has been very great. The banks have therefore made a very handsome and more than adequate return to the government as tested by the past or present experiences of European banks. On the other hand, the stockholding member banks have received a very small return, for, while they have nominally had 6 per cent on the amount invested in stock, it must always be remembered that the reserve banks paid no interest to members on deposited reserves, so that, in a close comparison of accounts, one would need to reduce the 6 per cent actually paid to the members very considerably in order to get a fair estimate of what these members had earned. Of course it would have to be borne in mind that the reserve banks have rendered to members very valuable services (even when they were not rediscounting for them) through their action in maintaining stability and equilibrium in the financial world, but these of course are intangible elements in the situation.

As for the legal aspect of the case, the Federal Reserve Board is of course vested with power to authorize expenditures, and has approved the outlays of the several banks for buildings and salaries and all other purposes. The government being the residual claimant of the assets of the banks in the event that the system should be disestablished, over and above their authorized capital surplus, etc., the only question which is at issue in this connection is whether the Federal Reserve Board has or has not been wise in allowing the temporary diversion of funds into real estate and buildings to an extent that was perhaps in excess of present requirements. The problem thus raised is technical and there are many factors which affect it in one way or another. There need be no effort at this time to pass final judgment upon it. It is enough to say, as has already been said, that the system has amply paid



its way and that its return to the government not merely in cash but in service has been very large

Membership

A more important point at which the efficiency of the reserve system is often brought into question is found in connection with its membership. Starting with the concept of the system as a small compact body of banks, all to have national charters and hence to be under direct national supervision, the Federal Reserve Act, before it reached the statute books, had broadened into a measure which provided for the admission of state banks on condition only that they should comply in a rough general way with the requirements governing admission into the national banking system.

Although the system now includes some 80 per cent of the commercial banking assets of the country, the number of its state bank members is only about 1,500 out of a general total of perhaps 20,000. Among these 20,000 many are ineligible owing to the form of their organization, and probably a large majority ineligible because of the smallness of their capitalization. Yet there are still very many state banks which are either eligible or could easily become so but which are not members of the system. Does this fact of failure to draw within its scope practically the entire banking community indicate anything very definite with respect to the success or failure of the federal reserve system?

Its success in increasing the number of its members and in drawing in the larger state banks of the cities has been hailed by many who judge success entirely on a basis of size or number, as being the hallmark of prosperity. In fact, it is nothing of the sort and we may well question whether the system has not been seriously in error in admitting to membership a good many state institutions which have in fact been taken in. We may question still more seriously whether the system is not in error in endeavoring to obtain additional

members, and we may ask with good reason whether in fact membership in the system is now too easily attainable and, finally, whether such membership today actually has the meaning that should be accorded to it. Doubtless membership in the federal reserve system is with many banks at the present time merely "advertising." It is true that, in order to give the system a prompt beginning, it was then deemed necessary to require membership on the part of all national banks. Yet national banks have at all times had the choice of remaining in the system or of shifting over to a state system if they chose. It is a fact that not more than about 50 per cent have at any time been discounters, while taking the whole number of members, it is probably true that a large percentage have never discounted at all, or at all events have done so only very sporadically. This, if it means anything, must mean that the system is not fulfilling the obligation which it ought to perform for its members, or else that its members are not of the proper kind. Probably both these statements have a basis.

Better Standards

Conditions would be improved if different standard of membership were applied, while the convenience of members might be much more greatly served than is the case at present. True it is, that not a few of the federal reserve banks have exerted themselves to the utmost to acquire popularity with their members and that in so doing they have assumed functions and done work that by no means belongs to them, undertaking duties whose performance without charge might well be regarded by local member banks as bordering upon undue or unfair competition. True it is, also, that practically all of the reserve banks have been anxious to serve the convenience of members, and so far as they knew how have sought to help them. But, of course, their ability to help has been circumscribed by the general conditions upon which the

system has been established, the regulations of the Federal Reserve Board, and a number of other factors

The reserve system would undoubtedly profit greatly if it could go back to the original conception, namely, that of a small body of banks engaged in practically pure commercial business whose condition was at all times liquid and who were in position to make steady use of the facilities of the system. The great body of members which now, like an outer ring of satellites, surrounds the inner core of the federal reserve system, is too nebulous in its relationships to the federal reserve banks, too much inclined to complain of failure to get from them a service which yields a direct profit, and too little disposed to adapt its principles to those of the federal reserve system itself or of the banks of the commercial centers in such a way as to obtain the maximum benefit of the membership. Taken all in all, the membership of the system today is unsatisfactory, and this unsatisfactoriness will not be overcome by increasing the number of members, although that is the direction in which all present efforts tend.

New Members

During sessions of Congress, it has been repeatedly urged that existing evils would be largely corrected if the smaller state banks could be admitted to the federal reserve system and given power to discount directly with the reserve banks. What good such power would do if these banks never possessed the paper that would enable them to do business with reserve banks, is not clear. The truth of the matter is that what is needed is not an extension of membership but the development of a more active membership, and to this end the better adaptation of the system to the needs of the members. Such adaptation will of course involve, before it is fully successful, a far greater degree of activity on the part of reserve banks in the open market transactions for which the system provided. The great evil in the present membership situation

lies in the fact that whereas reserve banks are cut off, or have cut themselves off, from much business except that which comes to them through the members, the latter do not perform any regular business with them and are disinclined to undertake such business except in cases of necessity. The reserve system would be a far more effective part of our financial organization if it had a much smaller volume of assets and far fewer members but materially increased its activities.

Let it not be understood that this end could be attained by releasing the smaller national banks from becoming members and confining membership, as was originally probably intended under the so-called Aldrich plan, to the relatively small number of banks in the cities. Mere reduction of membership gives greater power of control but does not change the character of the operations. It is a change in the latter that is needed and especially a change in the relationships between the reserve banks themselves and the member banks. The latter may be highly desirable members, even though of the smallest size, and they may be very undesirable even though of the largest size. The Federal Reserve Board, of course, has never had the power to alter or modify membership conditions except in so far as changes might result from administrative rulings which could be reshaped only within comparatively narrow limits. It has not, however, recommended to Congress any material change in conditions of membership, and the subject has continued without scientific or thorough treatment, although experience has shown that, under present conditions, the system is little more than an emergency means of banking protection and that this character can probably not be fully modified without changes in its composition.

A Central Bank?

Perennial in the whole discussion of banking has from the start been the controversy whether a central bank was desirable for the United States. It was opposition to the central bank

idea which, as has already been indicated, was responsible for the present structure of the federal reserve system. Yet the central bank idea is an outgrowth of actual conditions as we find them, and is difficult to dispose of by any mere mechanism of banking organization. The federal reserve system had an exceptionally hard task to perform in introducing its original type of organization. One of the difficulties, if not the greatest, which had to be encountered was found in the fact that so much of the country's banking strength centered around New York and in a lesser degree around a few other large financial centers. As the system has developed, nearly one-third of its assets belong to the Federal Reserve Bank of New York, the other two-thirds being distributed among the eleven other units in the system.

This preponderance of financial strength in one institution would naturally have given a somewhat "lopsided" development to the whole organization, but such lack of harmonious development has been considerably aggravated as a result of a variety of factors which, taken in the aggregate, have exerted a very profound influence. It is not intended in this general description of the results of eight years of experience to enter in any detail into the factors which have tended to give to the Federal Reserve Bank of New York the peculiar position which it occupies among federal reserve banks. As has been said, the basis for the development of such a position was afforded in the very structure of American banking itself, but it should be added that little has been done to diminish or reduce even in some gradual way the disproportion which has existed between the different districts of the country. Let it be clearly and positively stated that in this remark there is no intent to intimate that there should have been conscious effort to impair or reduce the pre-eminence as a financial center which had been earned by New York or which had been developed as the result of natural factors.

Speculation

Due, however, to the peculiar character of our banking system prior to 1914 there were many factors which tended to shift country bank funds to New York. The centering of stock exchange speculation in that city, the development of systems by which country bank funds were redeposited in large banks in New York, and in later years the system whereby an indirect control over "strings" of banks throughout the country had been developed by New York institutions, had brought about a more or less artificial condition of affairs in which a considerable quantity of country bank funds for whose transfer there was no natural warrant was steadily shifted from the country to the city.

This in itself was not a good thing. It is undoubtedly true that in every country which has a seasonal system of production, with heavy crop-moving demands at one season and slack business at another, there will be a condition in which a surplus of funds exists at many points for a series of months and a corresponding shortage exists at others. Such a condition is easily corrected under the branch bank system. Under our own system of independent and isolated banks, it could be properly provided for only through interbank accommodation such as was rendered by the reserve city bank system of the National Banking Law. Few students of banking can doubt that it would have been a very much better situation had our system of banking kept these funds in a liquid condition so that they could at all times be called home without question when they were wanted. Still better would have been the situation had there been assurance of local investment for a part of them, with the result that they were kept continuously at work in developing the business and industry of the various localities, instead of being sent to such localities only sporadically during the crop-growing and harvesting season.

It has been often asserted that the small country bank system of the United States has greatly tended to the develop-

ment of the smaller towns throughout the country, and in some aspects there is truth in this contention. In other aspects the argument has but little foundation, the use of such local country bank funds depending entirely upon the farsightedness of the country banker. In those towns or cities where such farsightedness was absent, or where the local banker preferred to speculate in stocks instead of lending in response to local demand, the country bank was often a kind of financial sponge which "mopped up" the spare cash of the community and sent it to banks at a distance to be employed by them in investment loans or in stock market operations.

Act Ineffective

All this the Federal Reserve Act provided a mechanism for remedying, in some measure at least. Such a remedy inevitably called for the hearty co-operation of the member banks of the different localities. Large city banks have, however, continued to draw to themselves the funds of country banks and to use them about as freely as ever in the stock market. Let it be carefully recalled at this point that legitimate dealings in stocks perform a valuable economic function and that there is no good reason why a stock market should not be properly and adequately financed. What is here said is not intended to convey the idea that there should be any unreasonable discrimination against the legitimate stock market, or any effort to "starve" that market or to deprive it of funds under proper conditions. What it is intended to say is that the working of the federal reserve system has apparently not succeeded in withdrawing from the stock market that overplus or surplus of funds belonging to banks and previously employed in stock market speculation, which is a peculiar American feature of financial organization. The federal reserve system has permitted the rediscounting of paper at all times to go on in such a way that city banks discount for their country correspondents in other districts with the assurance that they themselves will

be able to recoup by discounting paper at the federal reserve bank of their district

This system has undoubtedly operated against keeping at home the discount offerings of banks in those sections where the reserve bank rate was high. It has also tended to encourage city banks to put their funds into the stock market whenever rates there induced them to do so, in the belief that if need be they could obtain accommodation from city bank correspondents which in turn would obtain what they needed from their local reserve bank. Due to the preponderant size of the Federal Reserve Bank of New York, it was at all times possible for New York City banks to maintain this policy did they so choose. The fact is stated not necessarily as any criticism whatever upon the New York banks or upon the Federal Reserve Bank of New York. What was done was the outgrowth of the system under conditions which need not here be recapitulated. Nor is it necessary to inquire at this point whether the Federal Reserve Act itself gave to the system a sufficient power to correct the practices to which reference is here made. The point that it is desired to enforce is that the existence of the federal reserve system has not corrected this practice and shows no indication of so doing, and that so far as the writer is aware there has never been placed before Congress any plan for amending the act in such a way as to make it more operative in this particular—assuming that greater effectiveness on its part was desired.

In this particular, then, which before the adoption of the Federal Reserve Act was by many spoken of as the feature of the financial situation which called most earnestly for correction, the federal reserve system has been largely without result. True, it has provided a bulwark against the recurrent suspensions and "panics" which were in large measure the outgrowth of the previously existing state of things. It has rendered readily available an emergency remedy which could be used to correct the immediate results of the evils referred

to, but it has not, as many expected it to do, undermined or eradicated the evils themselves. Altogether, therefore, the establishment of the reserve system must be looked upon as having been decidedly disappointing in its relation to stock speculation.

In registering this conclusion a reference is probably warranted to the post-war conditions in which Liberty bonds were employed as collateral at reserve banks for the purpose of obtaining funds which were then used in the stock market—this without any reference to the provision of the law which forbade the lending of funds for stock market speculation. It may be said in reply that the reserve banks had no means of correcting the Liberty bond situation—that they were obliged under the law and regulations to lend freely upon Liberty bonds as collateral, and that when the borrowers had obtained these funds it was entirely outside the power of the reserve system to dictate the use that should be made of them. This is a technically good defense which it is not intended to discuss in this article, reference being merely made to the use of Liberty bonds in the way already referred to as perhaps the most striking, although fortunately a past, phase of the inability of the system to cope with the evil of excessive stock market loans. The evil is one which in another form may recur at almost any time and the problem how to correct it remains unsolved in fact if not in theory.

Power of New York

All these conditions have naturally tended to stimulate the gradual assumption by the Federal Reserve Bank of New York of the position which it should not enjoy in a system organized as was the federal reserve system. This is said again not as any criticism upon the Federal Reserve Bank of New York or its members, but as a bare statement of the fact which has developed itself as a result of conditions. Acting for the other banks as a buyer and distributor of acceptances, as an inter-

mediary between them and foreign banks, and in many other respects being continuously regarded and treated not merely by the Federal Reserve Board but by the government itself and in some measure by Congress as occupying a position quite different from that of the other federal reserve banks, it would have been strange indeed if this bank had not accepted and performed the duties which were thus assigned to it

Yet the assumption of such a position was and is undoubtedly against the intent of the Federal Reserve Act and is not warranted by the general sentiment of the community taking the country as a whole. The question how far the federal reserve system can succeed in developing a genuine live discount market in the several districts into which the country is divided, and the question how far it can thereby render the several divisions largely self-dependent, or, in so far as they are interdependent, how far it can make the federal reserve system the channel through which interdistrict relations are effected, are still to be worked out. There is certainly no one who could reasonably suppose that the federal reserve system would ever become the only channel through which financial relationships between districts were carried on. Many—indeed the large bulk—of such interdistrict financial relationships are of a kind with which the federal reserve system has little or nothing to do, and probably never would have. The complaint of the present system is not found in the failure of the reserve system to develop a monopoly of interdistrict relationships, but is found in the fact that, although the system has obtained a very large membership, it has not succeeded in exercising all of those interdistrict functions which necessarily belong to it and must necessarily be exercised if it expects to render its full service to the community.

Discount Market

Leaving questions of organization and management, and turning to those of a more strictly banking and financial nature,

the fundamental problem presented by the federal reserve system in its scientific aspect was probably that of the establishment of a discount market and of leadership of our credit system by means of a varying application of discount rates. This indeed is, in many respects, the fundamental problem of all central banking. In considering it, the student should bear in mind that the eight years just passed have afforded only an unsatisfactory opportunity for a test of the capabilities of the system—this for the obvious reason that, during much of that time, war financing has been the predominant occupation both of the system and of the financial community as a whole. Nevertheless, some lessons at least may be learned and some conclusions drawn with reference to the federal reserve system in this respect.

To one who reviews the discount rate history of the federal reserve system, the outstanding fact in the case doubtless is that there has been no time when the system could be said to be really the leader of the market or be able to make its discount rate "effective" for any considerable period. For the first two years after the organization of the system, the banks of the country were too well provided with funds and too little inclined to resort to the reserve banks for accommodation to permit the discount rates of the latter to be of any serious importance. The Federal Reserve Board itself, in its various annual reports, has from time to time called attention to the fact that only a few months after approximately the beginning of 1917 had the system begun to enjoy a real influence upon the credit situation, and that this influence was promptly broken and neutralized by the advent of the war in the spring of that year. It was not until the war was over and had been succeeded by a period of inflation which had brought the country close to disaster, that the discount rate again began to play much part in the control and direction of credit. There was perhaps an interval of a few months in which the effect of higher rates made itself an influence of moment in the financial

market, although even during that period the definitions adopted by the Federal Reserve Board with regard to commercial paper, the maturity of such paper, the Board's attitude on questions of eligibility, and the like, had a much greater influence. Deflation, which set in as a result of world-wide revolution in demand and prices, largely threw the system out of alignment with the commercial credit market, and once more rendered its rate relatively ineffective. Today, they have practically no relation to, or effect upon, current short-time commercial rates.

Reviewing the whole experience and concentrating attention upon the two periods of a few months each, during which the federal reserve discount rate was a real factor in current finances, the conclusion to be drawn must be very adverse to the success of the system as a leader of the market or as a moulder of credit. Probably the prime reason why the discount rate has not been more effective than it has been, is to be found in the fact that the system's accommodations were at all times made through member banks and depended upon their applications. Remembering that it has seldom been true that more than about 50 per cent of the members were ever rediscounters at any one time, it will be apparent that the system has never been in position to exert a real power over credit through its rediscounts, save in a purely indirect way. The act itself had foreseen that such would be the case and had accordingly provided for open-market operations, but the provision to that effect was sadly vitiated in the course of debate, such operations being at length confined to two-name paper—an outcome which necessarily would have handicapped the reserve banks in any effort to become an important factor in the open market. They have not, however, employed even the power that left them in any satisfactorily thorough way as regards open-market transactions. The volume of these transactions has always been small, relatively speaking, and the conditions under which they have been carried on have been such as

largely to prevent much influence from being exerted through them either upon the volume of credit or the rate at which it was sold. Various reasons for this kind of inactivity could perhaps be assigned. Had market conditions remained normal, and had the system gradually come into its full development free of the modifying influences of the war, more progress could have been made.

Emergency Work

The influence of the member banks, however, has been against any such activity on the part of the reserve banks. As a result of this state of things, the federal reserve banking system has undoubtedly become in some measure what the early banking-reform movement sought to build up, but what the Federal Reserve Act did not aim at—an emergency banking system. Its emergency character is seen in the extreme fluctuations in its volume of transactions which have at times in the short space of a year increased as much as 300 per cent and at other times shrunk about two-thirds of their former amount. No such extreme fluctuations are to be seen in the European central banks. These latter banks have developed a continuing business. They are regular participants in the money market—leaders and formers of financial conditions, instead of being subservient to them. As already observed at another point, the illustration so often used during the banking reform struggle wherein a central reserve bank was likened to a reservoir of water used to put out fire, was thoroughly misleading and erroneous. Foreign central banks are not comparable to reservoirs suddenly drawn upon to put out fire, they are far more nearly to be compared to fireproof construction whose purpose it is to prevent combustion. But the inability or refusal of federal reserve banks to participate actively in open-market transactions has prevented them from becoming leaders in the market and regular participants therein, and has retained them in the position of emergency institutions.

In these circumstances real influence over the discount market could hardly be expected. Since the extent of their participation in financial operations is largely outside of their control, depending as it does upon the rediscount activities of the member banks, the effectiveness of their rediscount rates must, of necessity, at all times be greatly limited. Real effectiveness can be attained only under very peculiar conditions. For this reason the work of the system in checking inflation, effective as it may be at times, is wholly ineffectual at others, while in strictly normal times the system can have but little influence in controlling or directing the course of interest rates save through very roundabout channels.

Lack of Paper Market

Closely connected with this failure to develop as a financial leader and with the unsuccess in building up an open market in which the "bank rate" would be "effective," must be noted the ill success that has been had in stimulating the growth of liquid paper in the American market. It was recognized from the inception of the Federal Reserve Act that much of the current talk and agitation about bankers' acceptances was without foundation, and the original act wisely limited these acceptances to genuine "salt water bills," growing out of actual oversea transactions. While there was and is probably no better paper in the world than the soundest and most liquid elements of our domestic single-name paper, a very large proportion of such paper is non-liquid, or at best only semi-liquid, while it affords no definite means of indicating to the general buyer the precise extent of its liquidity. There was also full recognition of the fact that a development of domestic acceptances based upon warehoused commodities would be of no benefit whatever, the warehousing of commodities, indeed, being in many cases good evidence of the non-liquid character of bank paper based upon it. No good purpose could be served, it was thought, by merely converting non-liquid paper from the

single-name to the double-name form. It was with the real nature of credit and not with the form in which it was embodied, that the banking system must deal.

Too much confidence should not be placed in mere figures relating to the growth of the acceptance in the American market. Nevertheless, it is worthy of note that the volume of acceptances afloat here, including non-member issues, was at one time estimated as high as one billion dollars, since when it has fallen away to about four hundred million dollars. This slackening in the volume of acceptances is partly due to the changes in business demand that have occurred, to the reduction of foreign trade, and to other circumstances which would have operated in the same way no matter what the development of the acceptance had been. But it is undoubtedly due to the disposition of the country bank to use its funds in a different way rather than to invest them in acceptances. It has never been possible to raise the number of accepting member banks in the entire country above 400, and the number has often been far below that. How far the process of accepting can be more widely diffused will probably remain a doubtful question for a long time. Thus far, however, it seems clear that but little success has been developed in making a market for the country bank acceptance. What has been done has been to place on the market the acceptances of large city banks in the belief that the country institutions would buy them as an investment instead of putting their funds into the stock market. The proposition has been essentially one-sided—a means of obtaining more funds for the use of city banks.

It may well be doubted that this type of acceptance development will ever succeed in producing the basis for a discount market. Certainly it is not a condition which exists in Great Britain, although it should be added that in that country there is an entirely different type of banking structure, the basis of Great Britain's banking system being found in a small and increasing body of institutions, all of considerable size and

many of them very large, which establish branches throughout the country. There is, therefore, no country bank problem of the kind that exists in the United States. How to adapt ourselves to the peculiar conditions of the United States in evolving a discount market is a question which has not yet been satisfactorily dealt with and, it should be added with regret, on which but little work seems to be in process.

Note Issue

One object which was set before the federal reserve system at the outset of its organization had been long held in mind during the early years of banking discussion. It was the question how to obtain a flexible or elastic note circulation. Indeed, this question had often been discussed to the exclusion of other more serious matters, and the power to issue notes had by many been erroneously identified with the lending capacity of the bank. It was a fact that the Aldrich bill (National Monetary Commission bill) which had preceded the Federal Reserve Act, had been built up largely around the idea of a flexible note issue. Some writers who have reviewed the history of the federal reserve system have been disposed to place great emphasis upon the problems of note issue, pointing out that in the beginning the concept which was adhered to by the system was that of providing a currency which should expand and contract as business needs expanded and contracted. On this point, as on most others, the federal reserve system has had to suffer from the character of the times upon which its organization fell and has had to reconcile itself to what it could, rather than what it would, do.

Strictly and carefully framed, the original provisions of the act were intended to prevent the issue of notes save as the result of the discount of actual bona fide commercial paper. This provision was speedily qualified through the development of evasive practices, prevailing throughout the system with the knowledge and consent of the Federal Reserve Board, which

soon made the original provision only a handicap and led to its withdrawal. Its place was taken by an amended section which was intended to permit the issue of notes to take place practically on a gold certificate basis. It would be an interesting matter of speculation to inquire how much this provision in and of itself would really have modified the original law had it been left to work without interruption. The entry of the United States into the war, however, and the hysterical effort to "conserve" gold soon led to a condition of practical suspension and to the concentration of gold and gold certificates in the hands of reserve banks. An immense expansion of federal reserve notes took their place, and when to this great outpouring of notes was added the large increment due to the artificial forcing of federal reserve bank notes into the circulation to take the place of retired silver certificates, it was believed by more or less careful students of the currency situation that, as a result of these changes, the note issue of the system had become quite inelastic. This view undoubtedly prevailed until the beginning of the year 1921.

Power to Contract

Experience since that time has shown the capacity of the note issue to contract as prices fell and demand for circulation was reduced. It is a fact that the theoretical elasticity of the new note currency has been entirely vindicated, or, in other words, if we eliminate from the entire volume of note currency in circulation in the United States all that part which represents gold or gold certificates held in store and all that part which has been issued to replace Treasury certificates or greenbacks, it will be found that the remaining volume of federal reserve notes, based as it is upon commercial paper, has shown in very considerable measure the attributes of elasticity which it was desired to secure. But this theoretic vindication is far from representing an actual accomplishment such as was hoped for when the act was first framed. Eventually it was hoped that

old certificates would be retired, and the gold trust funds of the country, in so far as released, would be deposited in reserve banks, and, in so far as turned over to the public, would be used by them to the extent that they were needed in current circulation, the remainder then being deposited with commercial banks of the country and through them in some proportion at least with reserve banks. The greenback, it was likewise hoped, would be retired through the use of the earnings of federal reserve banks, while of course no such artificial increase of federal reserve bank notes as later occurred was ever thought of.

Had matters worked out in this way, and particularly had the retirement of national bank notes at the rate provided in the original act proceeded, we should now, no doubt, have been well on toward attainment of the ideal of a single uniform currency, provided by federal reserve banks, resting upon an adequate gold reserve issued only for commercial paper, and expanding and contracting as business requirements made it needful. That object has certainly not been accomplished, and, with things as they now stand, there is little reason to believe that it will be at any time in the near future. Conditions working against it are today perhaps more adverse than at any time since the inauguration of the system, so that, all told, we must conclude that the success thus far experienced in the provision of a note currency such as was anticipated has been limited, not through any fault of the system itself, but by reason of the exceedingly difficult conditions to which it was subjected from the outset.

Effect of War Period

It is, of course, deeply to be regretted from one standpoint that during its early years our federal reserve system should have fallen upon such disturbed times. Organized during the first year of the European war, its whole purpose and object has been lost to sight as a result of the urgent requirements of

war financing, and the history of the system has necessarily been very different from what it would have been in other conditions. Not only has it become an emergency banking system, but from the very first the decisions to be taken upon essential issues have been consciously distorted and misshapen as a result of war requirements whose purposes have not always been obvious to the outsider, and whose objects when gained have sometimes proved to be of doubtful advantage. International considerations of a wholly unprecedented character have intervened to modify the system in its reserve aspects, and the vigilance of Congress, such as it was, has been largely relaxed because of the war, so that unwise amendments have been from time to time adopted. In happier times and with a more normal condition of the financial world, better results might have been accomplished, and yet this always is a two-sided matter. Had it not been for the war, there is no slight reason to expect that reactionary influences would have prevented the system from ever attaining full growth, would have kept it in financial swaddling clothes far beyond the time when it should have been free from such restriction, and would, in short, have succeeded in preventing the organization from showing what it could do.

As against such a condition, the system has, however, had an unusual opportunity of knowing its strength and has exhibited it. This was well, because the experience thus had constitutes an example which can never be erased and to which in later years reference will constantly be made by those who believe in the development of a strong central banking system actuated by considerations of public welfare. As it stands there has been a practical break of eight years in the discussion of banking from the scientific standpoint, in the United States. The period since 1914 has been so disturbed and uncertain as to permit of little in the way of suitable policy, and to compel very great modifications of thought on the part of financiers and publicists. But they will yet develop a more thoughtful

and scientific attitude toward the whole problem, it may be hoped, and, if so, the movement toward sounder banking will at least have been assisted by the illustrative experiences of the past eight years. Not least among these has been the demonstration of ability to perform the fiscal functions of the government on a scale and with an efficiency not previously thought of. Getting rid of the evils of the old sub-treasury system has been one of the important benefits bestowed as a result of the adoption of the Federal Reserve Act. Absence of much discussion of this point and cessation of scientific banking analyses in large measure, have of course retarded the development of thought and there has been a growth in many parts of the country of wholly unsound and dangerous "soft money" and "fiat credit" fallacies. How soon or by what means these can be eradicated and the experience of past years used to our benefit, is still uncertain.

Main Objects of System Not Achieved

Bearing all these factors of the banking problem in mind, however, we may now proceed to sum up some of the chief conclusions which suggest themselves to the mind of the student of our banking history during the years 1914-1922.

Outstanding among these conclusions is the fact that the federal reserve system has not accomplished the main objects for which it was intended and that in so far as it has achieved success in any direction it has become unpopular. By the side of this first and pessimistic conclusion must be placed the fact that the system has rendered far more distinctive services to the country within a short period of years than its inaugurators had ever any right to expect. It has not only attacked with considerable success and skill a good many of the problems which it had originally set before itself, but it has also grappled with a set of issues entirely unforeseen at the time the act was adopted, and in rendering to the government distinctive service during the war has proved its entire adequacy to the

solution of unprecedented problems developed during a time of financial trial such as the world had never before seen. Like many an individual, the federal reserve system has been great in emergency, but commonplace in the ordinary business of existence. So, when the emergency produced by war had passed, the failure of the system to develop a discount market or to exert as independent and courageous an influence as it should upon the distribution of credit has been notable.

Lack of Constructive Ability

It is perhaps not too severe a criticism to say that the system has shown but little constructive ability, and that while it has carried out some of the ideas embodied in the Federal Reserve Act, it has left others entirely undeveloped, acting upon them only slowly and reluctantly as circumstances demanded. One striking illustration is afforded by the provision of the Federal Reserve Act whereby the funds of the government were to be transferred to the reserve system. In this respect a nominal compliance was at first made, but in such a way as to amount to nothing. It was some time after the opening of the war before real compliance with the terms of the act was effected, and then only because circumstances compelled the Treasury to permit it. Not until after the war itself was over was the useless old sub-treasury system abolished.

There are many other points at which a like attitude of resistance and reluctance has been exhibited, and while there are doubtless some who would term this attitude conservatism and praise it as such, that point of view on their part could not be defended upon other than merely tactical ground. Noteworthy in this connection is the fact that among those who most retarded the development of the federal reserve system and its introduction of forward-looking ideas, a high place must be given to the politicians who at first put themselves forward as radical reformers. It was Secretary McAdoo who was most reluctant to effect the transfer of the

government funds to the reserve banks and Comptroller Williams who was slowest in accepting the mandate of the act concerning the relations between reserve banks and their members by giving to them the credit data concerning member bank conditions which they needed in order to build up their files. It is the supposedly popular or democratic members of Congress who have been most abusive toward every forward step in the process of popularizing the banking system and who have been most inclined to take the part of special interests. Of this latter disposition a striking example is seen in the effort to restrict the plan for the collection of checks at par and to defend the views of the small "tollgate" banks of the South which desired to be left free to charge as exorbitant rates of exchange as they saw fit.

While thus the federal reserve system cannot lay claim to complete success unless success is measured in terms of building operations, salaries, and assets, yet from that point of view its success is eminent and undisputed. It has made a place for itself not only in the country but in the world, and is already a model or pattern upon which various foreign banking systems have been shaped. It has succeeded to this extent because its original purpose had in view the public interest and requirements, and because it was without regard to the special welfare of those interests which had vitiated the earlier proposals for banking legislation. In proportion as the system slips away from these ideals and tends to stereotype itself upon existing lines and to content itself with self-satisfied advertising and approval of its own measures and acts, it will be likely to become less and less valuable to the community. It has already served its principal purpose under the existing form of organization, and the time has come when there should be an effort to bring it back to its original standards and to provide the basis for better and more public-spirited organization of our banking system. The danger in inaugurating such a movement is now, as always, that it may be taken possession of by

selfish politicians and business men who in the pretense of representing public welfare desire only to possess themselves of the "loaves and fishes" and to advance the interests of sections of the community

Enough proposed legislation amendatory of the Federal Reserve Act is now pending in Congress to destroy its purpose wholly, and among this vast array of bills few or none embody the amendments which are now so much to be desired and so essential if the system is to maintain a progressive attitude. The federal reserve system has done well and has deserved well of the community, it has been an emergency system actively and effectively functioning in a time of almost unique emergency. What it will do, how it will act, and what will be the attitude of the public toward it from this time forward, remains to be learned. One thing is certain. It is in unstable equilibrium and cannot be expected now to maintain its present position. It must go forward or consent to lose ground, perhaps ultimately to suffer the fate of other central banks which in the past were destroyed by demagogues.

APPENDIX
LEGISLATION . PROPOSED AND ACTUAL

APPENDIX I

FIRST COMPLETE DRAFT OF GLASS BILL¹

H R
In the House of Representatives
1913

Mr Glass of Virginia introduced the following bill which was referred to the Banking and Currency Committee and ordered to be printed

A BILL

To provide an elastic currency, furnish means of rediscounting commercial paper, protect the creditors of National Banking Associations, and establish a more effective supervision of banking in the United States

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled

SEC. 1 That the act of May 30, 1908, entitled "An Act to amend the National Banking Law," be and the same is hereby repealed

SEC. 2 That within sixty days after the passage of this act, the Secretary of the Treasury, the Attorney-General of the United States, and the Comptroller of the Currency, acting as a "Reserve Bank Organization Committee" shall designate from among the reserve cities now authorized by law a number of such cities to be determined by the said Organization Committee, and shall divide the Continental United States into an equal number of districts, each district to contain one of the said reserve cities designated by the Organization Committee hereinbefore established, provided, that the districts shall be apportioned with due regard to the convenience and customary course of business of the community, and shall not necessarily coincide with the area of such State or States as may be wholly or in part included in any given district. The districts thus created may be readjusted, and new districts may from time to time be created by the Federal Reserve Board hereinafter established, acting upon a joint application made by not less than 10 banks situated within one of the existing

¹ Glass bill substantially as presented to President elect at Trenton, February, 1913

districts, and holding stock in one of the Federal Reserve Banks hereinafter provided for. The districts thus constituted shall be known as Federal Reserve Districts and shall be designated by number according to the pleasure of the Organization Committee hereinbefore provided for.

The Organization Committee shall in accordance with regulations to be established by itself proceed to organize in each of the reserve cities designated as hereinbefore specified a Federal Reserve Bank. Such Federal Reserve Banks shall be known by the city and district in which they are situated,—as “Federal Reserve Bank of Chicago, First District,” etc.

The total number of reserve cities designated by the Organization Committee as hereinbefore provided shall not be less than 15 and in determining the said number, the Organization Committee hereinbefore created shall be authorized to receive applications from existing banks and organizations of banks, and to take testimony, to send for persons and papers, to administer oaths, and to make such investigations as may be deemed necessary by the said Committee for the purpose of determining the number of the reserve cities to be designated as herein provided.

Every National Bank located within a given district shall be required to subscribe to the Capital stock of the Federal Reserve Bank of that district a sum equal to 20 per centum of its own paid up and unimpaired capital, one-half of such subscription to be paid in under the terms and conditions prescribed by the National Banking Act with reference to subscriptions to the stock of National Banking Associations. The remainder of the subscriptions or any part thereof shall become a liability of the subscribers, subject to call and payment thereof whenever necessary to meet the obligations of the Federal Reserve Bank under such terms and in accordance with such regulations as the Board of Directors of said Federal Reserve Bank may prescribe, Provided, That no Federal Reserve Bank shall be organized with a paid up and unimpaired capital at the time of beginning business less in amount than \$5,000,000. The Organization Committee hereinbefore provided for shall have power to appoint such assistants and incur such expenses in carrying out the provisions of this act as it shall deem necessary, and such expenses shall be payable by the Treasury of the United States upon voucher approved by the Secretary of the Treasury, not to exceed in the aggregate \$50,000.

SEC 3 That the capital stock of each Federal Reserve Bank shall be divided into shares of \$100. The outstanding capital stock may be increased from time to time as subscribing banks increase their capital or as additional banks become subscribers, or may be decreased as subscribing banks reduce their capital or leave the organization by liquidation. Each Federal Reserve Bank may establish branch offices at a point within the Federal Reserve district in which it is located approved by the Federal Reserve Commission, after selection by the Board of Directors of said banking corporation, Provided, That the total number of such branches shall not exceed one for each \$500,000 of the capital stock of said Federal Reserve Bank.

SEC 4 That upon duly making and filing with the Comptroller of the Currency a certificate in the form required and described in sections 5134, 5135, and 5136, R. S., U. S., the National Banking Associations uniting to form a Federal Reserve Bank shall become a body corporate and as such and in the name designated in the organization certificate shall have power to perform all those acts and to enjoy all those privileges and to exercise all those powers described in section 5136 Revised Statutes, save in so far as the same shall be limited or extended as the case may be, by the provisions of this act.

Every Federal Reserve Bank shall be organized and conducted under the oversight and control of a Board of Directors whose powers shall be the same as those conferred upon the Boards of Directors of National Banking Associations under existing law, except in so far as expressly provided to the contrary in this act. Such Board of Directors shall be constituted and elected as hereinafter specified and shall consist of fifteen members holding office for three years and divided into three classes designated as Class A, B and C.

Class A shall consist of five members who shall be chosen by and be representative of the stockholding banks.

Class B shall consist of five members who shall be chosen by and be representative of the stockholders of the National Banks holding shares in the Federal Reserve Banks.

Class C shall consist of five members, four of whom shall be chosen by the Directors of Classes A and B with the approval of the Federal Reserve Commission hereinafter created and one of whom shall be designated by the Federal Reserve Commission. Directors of class C shall be regarded as representative of general public interests.

Directors of class A shall be chosen in the following manner:

It shall be the duty of the Chairman of the Board of Directors of the Federal Reserve Bank of the district in which each such bank is situated to classify the banks of the said district who are stockholders in the said Federal Reserve Bank into five general groups or divisions. Each such group shall contain as nearly as may be one-fifth of the aggregate banking capital of the banks holding stock in the Federal Reserve Bank of the said district and shall consist of banks belonging as nearly as may be to the same general classes of capitalization. The said groups shall be designated by number at the pleasure of the Chairman of the Federal Reserve Bank.

At a regularly called directors' meeting of each National Bank in the Federal Reserve District aforesaid, the Board of Directors of such National Bank shall elect by ballot one of its own members as a District Reserve Elector and shall certify his name to the Chairman of the Board of Directors of the Federal Reserve Bank of the district. The said Chairman shall establish complete lists of the District Reserve Electors, class A, thus named by banks in each of the aforesaid five groups and shall transmit one complete list to each such elector in each group. Every elector shall

within fifteen days of the receipt of the said list, select and certify to the said Chairman from among the names on the list pertaining to his group, transmitted to him by the chairman, one name as representing his choice for Federal Reserve Director, class A. The name receiving the greatest number of votes, not less than a majority, shall be designated by said Chairman as Federal Reserve Director, for the group to which he belongs. In case no candidate shall receive a majority of all votes cast in any district, the Chairman aforesaid shall establish an eligible list, including the three names receiving the greatest number of votes on the first ballot, and shall transmit said list to the electors in each of the groups of banks established by him. Each elector shall at once select and certify to the said Chairman from among the three names submitted to him his choice for Federal Reserve Director, Class A, and the name receiving the greatest number of such votes shall be designated by the Chairman as Federal Reserve Director, class A.

Directors of class B shall be chosen in the following manner:

At an annual election of officers of each National Bank the stockholders of said bank, if there be a vacancy among directors of class B in the group to which said bank may belong, shall choose one of their own number who shall not be either an officer or director of any bank as a District Reserve Elector, class B. The name of said District Reserve Elector shall be certified to the Chairman of the Board of Directors of the Federal Reserve Bank of the district in which such National Bank is located. It shall thereupon be the duty of said Chairman to establish and to secure the selection of one Director representing each of the five groups into which the banks of the district are divided from among the District Reserve Electors of class B, after the manner hereinbefore prescribed for the choice of Directors of class A.

Directors of class C shall be chosen in the following manner:

On the first day of July in each year when there shall be a vacancy among Directors of class C, the Directors of classes A and B of each Federal Reserve Bank shall, at a meeting called for that purpose, select one or more additional directors not to exceed four in number. Such additional directors shall be residents of the Federal Reserve district in which they are chosen and shall be fairly representative of the agricultural, industrial, and commercial interests of said district. None of such directors shall be during his term of office an officer or director of any other bank or banking corporation. Eight votes shall be necessary to the choice of each such director and before he shall be declared elected he shall be certified to the Secretary of the Treasury who with the advice and consent of the Federal Reserve Commission hereinafter created may accept or reject any or all such directors of class C.

A fifth director belonging to class C shall be chosen directly by the Federal Reserve Commission hereinafter created, under such regulations as it may prescribe. The said director shall be chairman of the Board of

Directors of the Federal Reserve Bank of the district to which he is appointed and shall be designated as "Federal Reserve Agent." In addition to his duties as chairman of the board of directors of the Federal Reserve Bank of the district to which he is appointed, he shall be required to maintain under regulations to be established by the Federal Reserve Commission, a local office of said Commission which shall be situated on the premises of the Federal Reserve Bank of the district. He shall make regular reports to the Federal Reserve Commission, and shall act as its official representative for the performance of the functions conferred upon it by this act. He shall be paid an annual compensation to be fixed by the Federal Reserve Commission and to be paid him monthly by the Federal Reserve Bank to which he is designated.

The Reserve Organization Committee heretofore created may in organizing Federal Reserve Banks for the first time call such meeting of bank directors or stockholders in the several districts as may be necessary to carry out the purposes of this act and may exercise the functions herein conferred upon the chairman of the board of directors of each Federal Reserve Bank, pending the complete organization of such bank.

At the first meeting of the full board of directors of each Federal Reserve Bank subsequent to the organization of such bank it shall be the duty of each of the three classes of directors heretofore created to designate by such method as shall be prescribed by the Federal Reserve Commission one of its members whose term of office shall expire at the end of one year from the first of January nearest the date of such meeting, one whose term of office shall expire at the end of two years from said date, one whose term of office shall expire at the end of three years from said date, one whose term of office shall expire at the end of four years from said date, and one whose term of office shall expire at the end of five years from said date. Thereafter every director of a Federal Reserve Bank chosen as heretofore provided shall hold office for a term of five years. Provided, that the chairman of the board of directors of each Federal Reserve Bank, designated by the Federal Reserve Commission as heretofore described shall be removable at the pleasure of the said Commission without notice, and his successor shall hold office during the unexpired term of the director in whose place he was appointed.

SEC 5 That shares of the capital stock of Federal Reserve Banks shall not be transferable, and under no circumstances shall they be hypothecated, nor shall they be owned otherwise than by subscribing banks, nor shall they be owned by any bank other than in the proportion herein provided. In case a subscribing bank increases its capital, it shall thereupon subscribe for an additional amount of capital stock of the Federal Reserve Bank of its district equal to twenty per centum of the Bank's own increase of capital, paying therefor the then book value of the shares of the Reserve Bank as shown by the last published statement of said Bank. A Bank applying for stock in a Federal Reserve Bank at any time after the formation of the

latter must subscribe for an amount of the capital of said Reserve Bank equal to twenty per centum of the capital of said subscribing bank, paying therefor its then book value as shown by the last published statement of said Reserve Bank. When the capital of any Federal Reserve Bank has been increased either on account of the increase of capital of the banks holding stock therein or on account of the increase in the number of stock-holding banks, the board of directors shall make and execute a certificate showing said increase in capital, the amount paid in and by whom paid. This certificate shall be filed in the office of the Comptroller of the Currency. In case a subscribing bank reduces its capital it shall surrender a proportionate amount of its holding in the capital of said Federal Reserve Bank, and if a bank goes into voluntary liquidation it shall surrender all of its holdings of the capital of said Federal Reserve Bank. In either case the shares surrendered shall be cancelled and the bank shall receive in payment therefor a sum equal to their then book value as shown by the last published statement of said Federal Reserve Bank.

SEC 6 That if any shareholder of a Federal Reserve Bank shall become insolvent and a receiver be appointed, the stock held by it in said Federal Reserve Bank shall be cancelled, and the balance after paying all debts due by such insolvent bank to said Federal Reserve Bank shall be paid to the receiver of the insolvent bank. Whenever the capital stock of a Federal Reserve Bank is reduced, either on account of a reduction in capital of the banks holding its stock or of the liquidation or insolvency of any such bank holding stock therein, the Board of Directors shall make and execute a certificate showing such reduction of capital stock and the amount repaid to each bank. This certificate shall be filed in the office of the Comptroller of the Currency.

SEC 7 That any National Banking Association heretofore organized may at any time within one year from the passage of this Act, and with the approval of the Comptroller of the Currency, be granted, as herein provided, all the rights, and be subject to all the liabilities, of National Banking Associations organized subsequent to the passage of this act, *Provided* That such action on the part of such Associations shall be authorized by the consent in writing of shareholders owning not less than two-thirds of the capital stock of the Association. Any National Banking Association now organized which shall not, within one year after the passage of this act, become a National Banking Association under the provisions hereinbefore stated, and which shall not place in the hands of the Treasurer of the United States the sums by law provided for the redemption of its circulating notes or which shall fail to comply with any other provision of this act, shall be dissolved, but such dissolution shall not take away or impair any remedy against such corporation, its stockholders or officers, for any liability or penalty which shall have previously been incurred.

SEC 8 That any bank or banking association incorporated by special law of any State or of the United States, or organized under the general

laws of any State or of the United States, and having a paid up unimpaired capital sufficient to entitle it to become a National Banking Association under the provisions of this act, may, by the consent in writing of the shareholders owning not less than two-thirds of the capital stock of such bank or banking association, and with the approval of the Comptroller of the Currency, become a National Banking Association under its former name or by any name approved by the Comptroller. The Directors thereof may continue to be the directors of the association so organized until others are elected or appointed in accordance with the provisions of the law. When the Comptroller has given to such bank or banking association a certificate that the provisions of this act have been complied with, such bank or banking association, and all its stockholders, officers and employees, shall have the same powers and privileges, and shall be subject to the same duties, liabilities, and regulations, in all respects, as shall have been prescribed for associations originally organized as National Banking Associations under this act.

SEC 9 That it shall be lawful for any National Banking Association having a capital of not less than \$1,000,000 to establish branches under such rules and regulations as may be prescribed by the Comptroller of the Currency, with the approval of the Secretary of the Treasury, Provided, that the number of such branches shall not exceed one for each \$500,000 of capital stock issued by the parent institution, and provided further that no branch shall be located outside the Federal Reserve District in which the parent bank has its head office.

SEC 10 That subsequent to a date one year from the passage of this act, any bank or banking association or trust company incorporated by special law of any state, or organized under the general laws of any state or of the United States, may make application to the Federal Reserve Commission hereinafter created for the right to subscribe to the stock of the Federal Reserve Bank organized within the Federal Reserve District in which such local bank or banking association or trust company exists. The Federal Reserve Commission may at its discretion, subject to the provisions of this section entitle such applying bank to become a stockholder in the Federal Reserve Bank of the district in which such applying bank is located, or at its discretion may reject such application. Whenever the Federal Reserve Commission may entitle such an applying bank to become a stockholder in the Federal Reserve Bank of the district in which the applying bank is located, stock shall be issued and paid for under the rules and regulations in this act provided for National Banks which become stockholders in Federal Reserve Banks.

It shall be the duty of the Federal Reserve Commission to establish by-laws for the general government of its conduct in acting upon applications made by the state banks and banking associations and trust companies hereinbefore referred to for stock ownership in Federal Reserve Banks. Such by-laws shall require of applying banks not organized under Federal

law that they comply with the reserve requirements and submit to the inspection and control provided in this act or in the National Banking Act, or in any other statute of the United States applicable to National Banking Associations. No such applying bank shall be admitted to stock ownership in a Federal Reserve Bank unless it possesses a paid up unimpaired capital sufficient to entitle it to become a National Banking Association in the place where it is situated, under the provisions of the National Banking Act, and unless it in every respect conforms to the provisions of the National Banking Act and the provisions herein prescribed for National Banking Associations of similar capitalization, organized in the localities where such applying banks are situated, and holding stock in a Federal Reserve Bank.

If at any time it shall appear to the Federal Reserve Commission that a banking association or trust company organized under the laws of any state or of the United States has failed to comply with the provisions of this section, it shall be within the power of the said Commission to require such banking association to surrender its stock in the Federal Reserve Bank in which it holds shares, upon receiving from such bank the then book value of the said shares in current funds and said Federal Reserve Bank shall upon notice from the Federal Reserve Commission be required to suspend the designated banking association from further privileges of rediscount and shall within thirty days of such notice cancel and retire its shares and make payment therefor in the manner herein provided. No such banking association shall again be eligible to acceptance as a stockholder in any Federal Reserve Bank.

SEC 11 That there shall be created a Federal Reserve Commission which shall consist of three classes of members hereinafter designated as classes A, B and C.

Class A shall consist of Federal Reserve Representatives, chosen by Federal Reserve Banks.

Class B shall consist of Government Reserve Representatives who shall be members ex officio of the Federal Reserve Commission.

Class C shall consist of Government Reserve Officers chosen by the President of the United States, and acting in the interest of the general public.

Federal Reserve Representatives (class A) shall be chosen by ballot by the directors of Federal Reserve Banks at a regular directors' meeting called for that purpose. Each Federal Reserve Bank shall be entitled to choose two representatives. One such Representative shall himself be a member of the directorate of the Federal Reserve Bank he represents, and one shall be a resident of the Federal Reserve District from which he is chosen, and shall not be at the time of his choice or during his term of office an officer or director in any bank or banking institution. The Chairman of the Board of Directors of each Federal Reserve Bank shall be ineligible for election as a member of the Federal Reserve Commission.

Government Reserve Representatives (Class B) shall be three in num-

ber and shall include the Secretary of the Treasury, the Secretary of Agriculture and the Comptroller of the Currency

Government Reserve Officers (class C) shall be nominated by the President of the United States and shall be confirmed by the Senate. They shall be three in number and shall be men learned in the theory and practice of banking, who shall not at the time of their selection be officers or directors of any Federal Reserve Bank. It shall be the duty of the President of the United States to designate one Government Reserve Officer as President of the Federal Reserve Commission, one as Vice-President of said Commission and one as Secretary of said Commission. The term of office of the Government Reserve Officers so designated as President shall be ten years and the terms of office of the officers designated as Vice-President and Secretary respectively shall be five years each.

Upon assembling for the first time the members of the Federal Reserve Commission belonging to class A shall separate into two groups under such regulations as the Commission shall lay down for effecting the said grouping. One such group shall hold office for three years dating from the first of January next succeeding the election of members, the other for six years succeeding such election. Each group shall include as nearly as may be, one-half the total number of members of Class A. Thereafter every member of the said Commission belonging to Class A shall hold office for a term of six years. Vacancies in class A shall be filled as they may occur, in the manner prescribed for the original choice of members belonging to the class in which such vacancies occur.

SEC 12 That the first meeting of the Federal Reserve Commission shall be held in Washington, D. C., as soon as may be after the passage of this act, and after the organization of Federal Reserve Banks in the several districts as herein provided, at a date to be fixed by the Reserve Organization Committee hereinbefore created.

At the said meeting the members of the Federal Reserve Commission belonging to class A shall choose from among their own number by ballot three members no two of whom shall have been originally selected by the same Federal Reserve Bank. At least one of such members shall have been originally selected from the directorate of a Federal Reserve Bank and at least one shall have been selected from outside such directorate in the manner hereinbefore provided.

The three members thus chosen from among the members of class A of the Federal Reserve Commission shall, with the members of classes B and C constitute an executive committee of the Federal Reserve Commission, which shall consist of nine members and shall be known as the Federal Reserve Board. The Secretary of the Treasury shall be ex officio chairman of the Federal Reserve Commission and chairman of the Federal Reserve Board.

The powers and functions hereinafter conferred upon the Federal Reserve Commission shall be exercised by the Federal Reserve Board in accordance

with by-laws to be established by said Commission but the said Board must fully report its action on each and every matter of business falling within its jurisdiction to a general meeting of the Commission to be convened not less frequently than four times each year

No member of class A who shall be chosen as herein provided a member of the Federal Reserve Board shall continue to hold office or to act as a director of any bank or banking institution or Federal Reserve Bank, and before entering upon his duties as a member of the Federal Reserve Board he shall certify under oath to the Secretary of the Treasury that he has complied with the requirements of this section, by withdrawing from any official or directoral relation of the kind herein referred to. Acceptance of membership in the Federal Reserve Board by any member of the Federal Reserve Commission shall automatically close the term of such member as a Federal Reserve Representative, and the Federal Reserve Bank from which he was originally chosen shall at once proceed to the choice of a successor in the manner hereinbefore described. Whenever a vacancy shall occur among the three members of the Federal Reserve Board who are chosen from among the members of class A, a successor shall within thirty days be chosen to fill the vacancy aforesaid by the method hereinbefore specified for the original choice, and when chosen the said successor shall hold office for the unexpired term of the member whose place he is selected to fill. The three members of the Federal Reserve Board chosen by Federal Reserve Representatives (class A) shall hold office for the terms for which they were originally selected as members of the Federal Reserve Commission by the method hereinbefore provided.

SEC. 13 That upon the nomination of the President of the Federal Reserve Commission, the Federal Reserve Board hereinbefore established shall appoint all officers and employees of the said Commission and of the said Board except as otherwise expressly provided for in this act. The Board shall have power to determine their remuneration, tenure of office and duties. The Federal Reserve Commission shall fix the compensation of all officers expressly named by the provisions of this act.

The Federal Reserve Board shall have full control, subject to the Federal Reserve Commission, of the detailed management of said Commission. For this purpose it shall meet regularly once a week at the office of the Commission or at such other places as may be designated by the Chairman of the Commission. Special meetings may be called by the Chairman or by any three members.

The Federal Reserve Commission shall appoint a Board of Examiners consisting of three members, to report at any time upon the conditions of credit, the kind of business done, and the proper conduct of the discounts at each Federal Reserve Bank of any individual bank, and said Commission may authorize the employment of suitable assistants, if needed, for this work of examination.

The Secretary of the Treasury as Chairman of the Federal Reserve

Commission and Chairman of the Federal Reserve Board shall be responsible for the discipline of the Executive Staff of the Commission determine the duties of the various persons concerned, secure the preparation of the reports to be made to the Federal Reserve Board and the members of the Commission, and perform all other duties pertaining to his office. All of his acts shall be subject to the review of the Federal Reserve Board and its decision in all matters pertaining to his duties shall be final unless reversed by the Commission. In the absence or illness of the Secretary of the Treasury his duties shall devolve upon the Comptroller of the Currency acting as Vice-Chairman.

The expenses of the Federal Reserve Commission and Board shall be paid by the Federal Reserve Banks out of their gross receipts in such a manner and at such time as the Commission shall direct. Each Reserve Bank shall pay such a portion of said expenses as its capital and surplus bear to the aggregate capital and surplus of all.

At all meetings of the Commission a quorum shall consist of two-thirds its total number of members. A majority of those present shall be required to pass any resolution. Each member shall be reimbursed for his reasonable travelling and other necessary expenses for attendance on each meeting, on vouchers approved by the Federal Reserve Board.

Sec 14 That the Federal Reserve Commission hereinbefore established shall be authorized and empowered

(a) To examine once each month at its discretion the accounts and books of each Federal Reserve Bank

(b) To determine the apportionment of Federal deposits among the Federal Reserve Banks

(c) To require or permit a Federal Reserve Bank to rediscount paper of any other Federal Reserve Bank

(d) To ascertain once each month the character of the paper held by each Federal Reserve Bank, and to require at its discretion the suspension of further issues of circulatory notes for a designated period

(e) To establish each week or as much oftener as required a rate of discount which shall be mandatory upon each Federal Reserve Bank and for each class of paper, provided that said rate of discount need not be uniform for all reserve banks, and provided further that the Federal Reserve Commission shall graduate the rate of discount made mandatory upon any Federal Reserve Bank in proportion to the extent of the issues and deposit liabilities as compared with the reserve funds of such banks

(f) To suspend for a period not exceeding thirty days (and to renew such suspension for periods of not to exceed fifteen days) any and every reserve requirement specified in this act

(g) To establish at its discretion a graduated tax which shall be uniform in its application to all reserve banks upon the amounts by which the reserve of any such bank is permitted to fall below the reserve level specified in this act

(h) To establish at its discretion a rate or rates of interest which shall be paid by Federal Reserve Banks on the net deposits of the Government with them

SEC 15 That any Federal Reserve Bank may receive from any bank or banking institution or trust company duly organized under Federal or State law deposits of current funds in lawful money, national bank notes, Federal reserve notes or checks, drafts and other claims upon solvent banks domestic and foreign

Upon the endorsement of any bank having a deposit with it any Federal Reserve Bank may discount notes and bills of exchange arising out of commercial transactions, that is notes and bills of exchange issued or drawn for agricultural, industrial or commercial purposes, the Federal Reserve Board to have the right to determine or define notes, etc., within the meaning of this act, and not including notes or bills issued or drawn for the purpose of carrying stocks, bonds or other investment securities, except notes or bills having a maturity not exceeding four months and secured by United States bonds and bonds issued by any State, county or municipality of the United States Such notes and bills must have a maturity of not more than thirty days

Upon the endorsement of any bank having a deposit with it, any Federal Reserve Bank may discount paper of the classes hereinbefore described having a maturity of more than thirty and not more than 120 days, provided that its own cash reserve exceeds 50 per cent of its total outstanding demand liabilities and provided further that not more than 50 per centum of the total paper so discounted for any depositing bank shall have a maturity of more than sixty days

Upon the endorsement of any bank having a deposit with it, any Federal Reserve Bank may discount acceptances of depositing banks which are based on the exportation or importation of goods or on travelers credits and which mature in not more than 90 days and bear the signature of at least one bank in addition to that of the acceptor The amount so rediscounted shall at no time exceed the capital of the bank for which the rediscounts are made The aggregate of such notes and bills bearing the signature or endorsement of any one person, company, firm or corporation, rediscounted for any one bank, shall at no time exceed ten per centum of the unimpaired capital and surplus of said bank

Any National Bank may at its discretion accept drafts or bills of exchange drawn upon it having not more than four months to run and growing out of transactions involving the importation or exportation of goods or the issue of travelers letters of credit Provided that no bank shall accept such bills to an amount equal in the aggregate to more than one-half the face value of its paid up and unimpaired capital

SEC 16 Whenever in the opinion of the Federal Reserve Board upon application jointly and directly made to the Secretary of the Treasury by not less than ten National Banks in one district the public interest so re-

quires, the Federal Reserve Board may authorize the Reserve Bank of the district to discount the direct obligations of depositing banks secured by the pledge and deposit with it of satisfactory securities, but in no case shall the amount so loaned by a Federal Reserve Bank exceed three-fourths of the actual value of the securities so pledged, or one-half the amount of its own paid up and unimpaired capital

SEC 17 That any Federal Reserve Bank may at its own discretion purchase in the open market either from domestic or foreign banks or individuals bankers bills and bills of exchange of the kinds and maturities by this act made eligible for rediscount, and satisfactory commercial paper

SEC 18 That every Federal Reserve Bank shall have power, both at home and abroad, to deal in gold coin or bullion, to make loans thereon, and to contract for loans of gold coin or bullion, giving therefor, when necessary, acceptable security, including the hypothecation of its holdings if any, of United States bonds

SEC 19 That any Federal Reserve Bank may invest in United States bonds, also in obligations, having not more than one year to run, of the United States or its dependencies, or of any state, or of foreign governments

SEC 20 That every Federal Reserve Bank shall have power to purchase from depositing banks and to sell with or without its endorsement, notes, drafts, or bills of exchange, arising out of commercial transactions as herein-before defined, payable in such foreign countries as the Board of Directors of such Federal Reserve Bank may determine. These bills of exchange must have not exceeding ninety days to run and must bear the signature of two or more responsible parties, of which the last one shall be that of a subscribing bank

SEC 21 That any Federal Reserve Bank may with the consent of the Federal Reserve Board open and maintain banking accounts in foreign countries and establish agencies in such countries wheresoever it may deem best for the purpose of purchasing, selling and collecting foreign bills of exchange, and it shall have authority to buy and sell with or without its endorsement through such correspondents or agencies, checks, drafts or prime foreign bills of exchange arising out of commercial transactions, which have not exceeding ninety days to run, and which bear the signature of two or more responsible parties

SEC 22 That the Government of the United States and banks depositing in the Federal Reserve Banks formed under this act as hereinafter indicated shall be the only depositors in said Reserve Banks. All domestic transactions of the Federal Reserve Banks involving the creation of deposit accounts shall be confined to the Government and the depositing banks, with the exception of the purchase or sale of Government or State securities or securities of foreign governments or of gold coin or bullion

SEC 23 That all moneys now held in the general fund of the Treasury shall within twelve months from the passage of this act be deposited in

Federal Reserve Banks, and thereafter the revenues of the Government shall be regularly deposited in such banks and disbursements shall be made by check drawn against such deposits. The Federal Reserve Board herein established shall apportion the funds of the Government among the said Federal Reserve Banks and it may at its discretion fix from month to month a rate of interest which shall be regularly paid by the banks holding such deposits, Provided, that no Federal Reserve Bank shall be required to receive Government deposits when in the judgment of its directors the condition of business does not warrant the payment of the rate of interest fixed by the Federal Reserve Commission.

SEC 24 That no Federal Reserve Bank shall pay interest on deposits except those of the Government of the United States and no National Banking Association shall pay interest on funds of other banks deposited with it.

SEC 25 That any Federal Reserve Bank may at its discretion, subject to the provisions of this act, make application to the Federal Reserve Commission through the Local Federal Reserve Agent for Federal reserve notes. Said notes shall be in all respects similar to existing National bank notes except that they shall not bear any legend or superscription indicating that they are secured by United States or other bonds. Upon receiving an application for notes from any Federal Reserve Bank, the Federal Reserve Commission shall immediately issue said notes to the Bank making said application. Any Federal Reserve Bank desiring to reduce its circulation may do so, upon the same conditions now prescribed for the retirement of National bank notes, Provided, that nothing in the statutes of the United States shall prevent a Federal Reserve Bank from retiring its outstanding notes as rapidly as its officers and directors may deem best.

It shall be the duty of every Federal Reserve Bank to receive on deposit at par the notes of every other Federal Reserve Bank and of every National Banking Association. Every Federal Reserve Bank shall provide for the redemption of its own notes on demand in gold at one point at least in every reserve district throughout the United States. The method of such redemption and the provisions under which it shall be carried on shall be subject to control by the Federal Reserve Commission, and it shall be the duty of said Commission to establish such rules and regulations that all notes issued by Federal Reserve Banks shall be maintained convertible into gold at par without exchange throughout the United States.

It shall be the duty of every Federal Reserve Bank to receive on deposit at par and without charge for exchange checks and drafts drawn by any of its stockholders or depositors upon any other stockholder or depositor and checks and drafts drawn by any stockholder or depositor in any other Federal Reserve Bank upon funds to the credit of said stockholder or depositor in said Reserve Bank last mentioned. The Federal Reserve Board shall make and promulgate from time to time regulations governing the transfer of funds at par among Federal Reserve Banks and may at its discretion exercise the functions of a Clearing House for such Federal Reserve Banks,

and may also require each such bank to exercise the functions of a clearing house for its shareholding banks

SEC 26 That no National Banking Association shall be entitled to receive from the Comptroller of the Currency, or to issue circulating notes in excess of the total amount of such notes which such bank may have outstanding at the passage of this act. Provided, that no National Banking Association which may in future reduce its outstanding circulating notes in the manner prescribed by law shall hereafter be entitled to receive from the Comptroller of the Currency, or to issue, circulating notes in excess of the sum to which its outstanding notes shall have been reduced by such withdrawals

SEC 27 That so much of the provisions of section 5150 of the Revised Statutes of the United States and section 4 of the Act of June 20th, 1874, and section 8 of the Act of July 12th, 1882, and of any other provisions of existing statutes as require that before any National Banking Association shall be authorized to commence banking business it shall transfer and deliver to the Treasurer of the United States, United States registered bonds, to an amount, where the capital is \$150,000 or less, not less than one-fourth of its capital stock, and \$50,000 where the capital is in excess of \$150,000, be and the same is hereby repealed

SEC 28 Upon application, the Secretary of the Treasury shall exchange the two per centum bonds of the United States bearing the circulation privilege theretofore deposited by any National Banking Association with the Treasurer of the United States as security for circulating notes, for three per centum bonds of the United States without the circulation privilege, payable after twenty years from date of issue, and exempt from Federal taxation both as to income and principal. When and in proportion as the outstanding two per centum bonds deposited with the Treasurer shall be thus exchanged or refunded, the power of National Banks to issue circulating notes secured by United States bonds shall cease and determine. Every National Bank may continue to apply for and receive from the Comptroller of the Currency circulating notes under the conditions provided by this act, but no National Bank shall be permitted to issue circulating notes of any description or to issue or to make use of any substitute for such circulating notes in the form of Clearing House certificates, cashier's checks, or other obligation not specifically provided for under this act. Provided, That no National Bank shall without the consent of the Secretary of the Treasury in any one year present two per centum bonds for exchange in the manner hereinbefore provided to an amount exceeding five per centum of the total amount of bonds deposited with the Treasurer by said bank at the time of the passage of this Act, Provided further that at the expiration of twenty years from the passage of this act every holder of United States two per centum bonds then outstanding shall receive in exchange three per centum bonds of like denomination payable twenty years from date of issue. Each Federal Reserve Bank may receive from the Federal Reserve Com-

mission and issue at its own discretion subject to the provisions of this act, in addition to the notes provided for by Sec 25 of this act, a sum in notes equal to the par value of two per centum bonds of the United States surrendered by its own stockholding banks to the Treasurer of the United States in exchange for three per centum bonds, provided that such additional notes transferred to Federal Reserve Banks shall be free from all except circulation taxes

SEC 20 That within sixty days from and after the date when the Secretary of the Treasury shall have officially announced in such manner as he shall select to National Banks situated in the several Federal Reserve Districts the fact that a Federal Reserve Bank has been established in the district in which each such bank is situated, every such National Banking Association wherever situated within said district shall establish with the Federal Reserve Bank of that district a credit balance on the books of the latter institution equal to not less than five per centum of the total outstanding demand liabilities, exclusive of circulating notes, of the National Banking Association establishing the same Such balance may at any time be increased but shall at no time be allowed to fall below a figure equal to the five per cent of outstanding deposit liabilities aforesaid

From and after the passage of this act, it shall be the duty of National Banking Associations now classified as country banks and situated outside of Central Reserve and Reserve Cities to maintain a reserve equal to fifteen per centum of the aggregate amount of its deposits Such reserve shall consist to the extent of one-third of lawful money held actually in the vaults of the banking office of such National Banking Associations Such reserve shall consist to the extent of at least one-third of current funds or balances due to such Association by the Federal Reserve Bank of the district in which such Association is situated, from and after the date upon which the National Banking Association in question shall have become a depositor in the Federal Reserve Bank of its district as hereinbefore provided The remaining one-third of the fifteen per cent reserve hereinbefore required may consist of balances due to an association from associations organized under the National Banking Act in reserve or central reserve cities as now defined by law

From and after the passage of this act for a period of fourteen months it shall be the duty of National Banking Associations now classified as Reserve City Banks and situated in existing reserve cities to maintain a reserve equal to twenty-five per centum of the aggregate amount of their outstanding deposits For a period of twelve months from the expiration of the fourteen months aforesaid it shall be the duty of said National Banking Association to maintain a reserve equal to twenty-two and one-half per cent of their outstanding deposits From and after the expiration of said period of twelve months last aforesaid it shall be the duty of said National Banking Associations to maintain a reserve equal to twenty per cent of their outstanding deposits Every such National Banking Association shall

for a period of sixty days after the passage of this act maintain constantly on hand in its own vaults in lawful money a sum equal to twelve and one-half per cent of its outstanding deposits, and subsequent to the expiration of said sixty days and at all times thereafter a sum equal to ten per cent of its outstanding deposits, the aforesaid twelve and a half and ten per cent, respectively, constituting a part of and being included in the twenty-five per cent reserve, the twenty-two and one-half per cent reserve and the twenty per cent reserve hereinbefore required. From and after the passage of this act, the net difference between the reserve required to be maintained in lawful money in the vaults of National Banking Associations situated in reserve cities, plus the deposit balance to the credit of such Associations on the books of the Federal Reserve Bank of the district in which they are situated and the total amount of required reserve, may consist of balances of current funds with National Banking Associations in cities now designated as central reserve cities. Such difference may at the discretion of each National Banking Association be kept in lawful money in its own vaults or may consist of balances with the Federal Reserve Bank of the District in which such Association is situated.

From and after the passage of this act for a period of fourteen months it shall be the duty of National Banking Associations now classified as central reserve city banks and situated in existing reserve cities to maintain a reserve equal to twenty-five per cent of the aggregate amount of their outstanding deposits. For a period of twelve months from the expiration of fourteen months aforesaid it shall be the duty of said National Banking Associations to maintain a reserve equal to twenty-two and one-half per cent of their outstanding deposits. From and after the expiration of said twelve months last aforesaid, it shall be the duty of said National Banking Associations to maintain a reserve equal to twenty per cent of their outstanding deposits. Every such National Banking Association shall for a period of sixty days after the passage of this act maintain constantly on hand in its own vaults in lawful money a sum equal to twenty per cent of its outstanding deposits, and subsequent to the expiration of the said sixty days and at all times thereafter a sum in lawful money equal to at least ten per centum of its outstanding deposits. The net difference between the minimum amount of lawful money actually required to be held in the vaults of said National Banking Associations situated in central reserve cities and the total amount of required reserve as hereinbefore specified may consist of balances due from the Federal Reserve Bank of the district in which such Associations are situated, or of lawful money actually held in the vaults of such Associations in addition to the required minimum hereinbefore specified, Provided, that the net balance to the credit of such Associations on the books of the Federal Reserve Bank of the district in which they are situated shall at no time fall below the five per centum of outstanding deposits hereinbefore required to be established within sixty days from the passage of this act.

SEC 30 That so much of section 3 of the Act of June 20th, 1874, entitled "An act fixing the amount of United States notes, providing for a redistribution of the National Bank Currency, and for other purposes," as provides that the fund deposited by any National Banking Association with the Treasurer of the United States for the redemption of its notes shall be counted as a part of its lawful reserve as provided in the act aforesaid be, and the same is hereby repealed And from and after, passage of this act, such fund of five per centum shall in no case be counted by any National Banking Association as a part of its lawful reserve

SEC 31 That every Federal Reserve Bank shall at all times have on hand in its own vaults in gold or the equivalent thereof a sum equal to not less than 25 per centum of its outstanding demand liabilities, which shall at the same time be not less than 50 per centum of its outstanding circulating notes It shall at all times have on hand in its own vaults live commercial paper having not more than 30 days to run to an amount equal to 50 per centum of its outstanding demand liabilities which shall at the same time be not less than 75 per centum of its outstanding circulating notes

SEC 32 That the Federal Reserve Commission shall as often as it deems best, and in any case not less frequently than four times each year, order an examination of National Banking Associations in reserve cities Such examination shall show in detail the total amount of loans made by each bank on demand, on time and the different classes of collateral held to protect the various loans And the Federal Reserve Board shall have power when in its judgment the result of such examination requires, to order that for a period of thirty days next following the demand deposits carried by other banks with any one or more of the Associations so specially examined shall not be counted as a part of the required reserve of the depositing institution

SEC 33 The earnings of each Federal Reserve Bank shall be disposed of in the following manner

After the payment of all expenses and taxes, the shareholder shall be entitled to receive an annual dividend of five per centum on the paid in capital, which dividend shall be cumulative Further annual net earning shall be disposed of as follows First, a contingent fund shall be created, which shall be maintained at an amount equal to one per centum on the paid in capital, and shall be used to meet any possible losses Such fund shall, upon the final dissolution of a Federal Reserve Bank, be paid to the United States and shall not under any circumstances be included in the book value of the stock or be paid to the shareholders Second, one-half of additional net earnings shall be paid into the surplus fund of each Federal Reserve Bank until said fund shall amount to twenty per cent of the paid in capital of such Bank, and the remaining one-half shall be paid to the United States, and whenever and so long as the surplus fund of such Federal Reserve Banks amounts to twenty per centum of the paid in capital and the shareholders shall have received the dividends at the rate of five

per centum per annum hereinbefore provided for all excess earnings shall be paid to the United States

SEC 34 The shareholders of every Federal Reserve Bank shall be held individually responsible, equally and ratably, and not one for another, for all contracts, debts and engagements of such Federal Reserve Bank to the extent of ten times the amount of their paid up stock therein at the par value thereof in addition to the amount invested in such shares

Contracts, debts and engagements of any Federal Reserve Bank, which may remain unprovided for after the exhaustion of the stockholders' liability created by the terms of this section shall become a joint liability of all other Federal Reserve Banks organized under the provisions of this act and shall by them be liquidated in proportion to their paid up capitalization

The ascertainment and apportionment of the liability of Federal Reserve Banks for the obligations of any one of their number remaining unpaid after the exhaustion of the stockholders' liability hereinbefore provided for shall be effected and certified to such banks by the Federal Reserve Commission and each Federal Reserve Bank when so informed of its liability shall pay into the hands of the Federal Reserve Commission within thirty days after notice the sum necessary to extinguish its liability Such sums shall be applied by the Federal Reserve Commission to the extinguishment of the contracts, debts or engagements for whose liquidation they were apportioned and collected

SEC 35 That from and after the passage of this act the stockholders of every National Banking Association shall be held individually responsible for all contracts, debts, and engagements of such Association, each to the amount of his stock therein, at the par value thereof in addition to the amount invested in such stock The stockholders in any National Banking Association who shall have transferred their shares, or registered the transfer thereof, within sixty days next before the date of the failure of such Association to meet its obligations, shall be liable to the same extent as if they had made no such transfer, but this provision shall not be construed to affect in any way any resources which such shareholders might otherwise have against those in whose names such shares are registered at the time of such failure

SEC 36 That section 324 of the Revised Statutes of the United States be amended so as to read as follows "There shall be in the Department of the Treasury a Bureau charged, except as in this act otherwise provided, with the execution of all laws passed by Congress relating to the issue and regulation of currency issued by National Banking Associations, the chief officer of which Bureau shall be called the Comptroller of the Currency, and shall perform his duties under the general direction of the Secretary of the Treasury, acting as the Chairman of the Federal Reserve Commission"

SEC 37 That the examination of the affairs of every National Banking Association authorized by existing law, shall take place at least twice in each calendar year, and as much oftener as the Comptroller of the Cur-

rency shall consider necessary in order to furnish a full and complete knowledge of its condition, and the person making such examination shall, except that the Secretary of the Treasury may at any time order an examination, have power to call together a quorum of the directors of such Association, who shall, under oath, state to such examiner the character and circumstances of such of its loans or discounts as he may designate, and from and after the passage of this act all bank examiners shall receive fixed salaries, the amount whereof shall be determined by the Federal Reserve Board and shall be annually reported to Congress. But the expense of the examinations herein provided for shall be assessed by the Comptroller of the Currency upon the Associations examined in proportion to assets. The Comptroller of the Currency shall so arrange the duties of National Bank examiners that no two successive examinations of any Association shall be made by the same examiner.

In addition to the examinations made and conducted by the Comptroller of the Currency, every Federal Reserve Bank may with the approval of the Federal Reserve Commission arrange for special or periodical examination of the banks within its district. Such examination shall be so conducted as to inform the Federal Reserve Bank under whose auspices it is conducted of the condition of its member or stockholding banks and of the lines of credit which are being granted by them. Every Federal Reserve Bank shall at all times be bound to furnish to the Federal Reserve Board such information as may be demanded by the latter concerning the condition of any National Bank organized within the district in which the said Federal Reserve Bank is located, and it shall have power at all times to order special examinations without notice of the condition of its member or stockholding banks.

SECTION 38 That no National Bank shall hereafter make any loan or grant any gratuity to any examiner of such Bank. Any Bank offending against this provision shall be deemed guilty of a misdemeanor, and shall be fined not more than \$1,000 and a further sum equal to the money so loaned or gratuity given, and the officer or officers of a Bank making such loan or granting such gratuity shall be likewise deemed guilty of a misdemeanor, and shall be fined not to exceed \$500. Any examiner accepting a loan or gratuity from any Bank examined by him shall be deemed guilty of a misdemeanor, and shall be fined not more than \$500 and a further sum equal to the money so loaned or gratuity given, and shall forever thereafter be disqualified from holding office as a National Bank examiner. No National Bank examiner shall perform any other service for compensation while holding this office.

Sec 39 That any National Banking Association not situated in a Reserve City or Central Reserve City may make loans secured by improved and unencumbered farm land, and so much of section 5137, Revised Statutes, as prohibits the making of such loans by banks so situated shall be and the same is hereby repealed, provided, that no such loan shall be made to an

amount exceeding 50 per centum of the actual value of the property offered as security, and such properties shall be situated within the Federal Reserve District in which the said Bank is located, and provided further that the aggregate amount of such loans made by any one bank shall not exceed a sum equal to 25 per cent of the capital and surplus unimpaired, of such bank.

The Federal Reserve Commission shall have power from time to time to add to the list of cities in which National Banks shall not be permitted to make loans secured upon real estate in the manner described in this section.

SEC 40 That the Comptroller of the Currency in addition to the reports provided for by existing law, shall have authority to call for such other reports, regular or special, from any National Banking Association as he may deem advisable, and such reports shall be rendered in such form as the Comptroller may prescribe, and each Association making such report shall cause a copy thereof to be conspicuously displayed in a public place in its banking house for the period of thirty days from the date of such report, but nothing herein contained shall be construed to require the publication of such additional reports by each Association in the manner prescribed for other reports now rendered.

SEC 41 That banking corporations for carrying on the business of banking in foreign countries and in aid of the commerce of the United States with foreign countries and to act when required as fiscal agents of the United States in such countries may be formed by any number of persons, not less in any case than five, who shall enter into articles of association which shall specify in general terms the object for which the banking corporation is formed, and may contain any other provisions not inconsistent with the provisions of this section which the banking corporation may see fit to adopt for the regulation and conduct of its business and affairs, which said regulations shall be signed, in duplicate, by the persons uniting to form the banking corporation, and one copy thereof shall be forwarded to the Comptroller of the Currency and the other to the Secretary of State, to be filed and preserved in their offices.

That the persons uniting to form such banking corporation shall, under their hands, make an organization certificate which shall specify, first, the name assumed by such banking corporation, which name shall be subject to approval by the Comptroller, second, the foreign country or countries or the dependencies of the United States where its banking operations are to be carried on, third, the place in the United States where its home office shall be located, fourth, the amount of its capital stock and the number of shares into which the same shall be divided, fifth, the names and places of residence of the shareholders and the number of shares held by each of them, and sixth, a declaration that said certificate is made to enable such persons to avail themselves of the advantages of this section.

That no banking corporation shall be organized under the provisions of this section with a less capital than two million dollars, which shall be fully

paid in before the banking corporation shall be authorized to commence business, and the fact of said payment shall be certified by the Comptroller of the Currency, and a copy of his certificate to this effect shall be filed with the Secretary of State, *Provided*, that the capital stock of any such bank may be increased at any time by a vote of two-thirds of its shareholders, with the approval of the Comptroller of the Currency, and that the capital stock of any such bank which exceeds two million dollars may be reduced at any time to the sum of two million dollars by the vote of shareholders owning two-thirds of the capital

That every banking corporation formed pursuant to the provisions of this section shall for a period of twenty years from the date of the execution of its organization certificate be a body corporate, but shall not be authorized to receive the deposits in the United States nor transact any domestic business not necessarily related to the business being done in foreign countries or in the dependencies of the United States. Such banking corporations shall have authority to make acceptances, buy and sell bills of exchange or other commercial paper relating to foreign business, and to purchase and sell securities, including securities of the United States or of any State in the Union. Each banking corporation organized under the provisions of this section shall have power to establish and maintain for the transaction of its business a branch or branches in foreign countries, their dependencies, or the dependencies of the United States at such places and under such regulations as its Board of Directors may deem expedient.

A majority of the shares of the capital stock of such banking corporation shall be held and owned by citizens of the United States or corporations chartered under the laws of the United States or of any State of the Union, and a majority of the members of the Board of Directors of such banking corporations shall be citizens of the United States. Each director shall own in his own right at least one hundred shares of the capital stock of the banking corporation of which he is a director.

Whenever the Comptroller shall become satisfied of the insolvency of any such banking corporation he may appoint a receiver, who shall proceed to close up such corporation in the same manner in which he would close a national bank, the disposition of the assets of the branches to be subject to any special provisions of the law of the country under whose jurisdiction such assets are located.

The annual meeting of every such banking corporation shall be held at its home office in the United States, and every such banking corporation shall keep at its home office books containing the names of all stockholders of such banking corporation and members of its board of directors together with copies of the reports furnished by it to the Comptroller of the Currency exhibiting in detail and under appropriate heads the resources and liabilities of the banking corporation. Every such banking corporation shall make reports to the Comptroller of the Currency at such times as he may require, and shall be subject to examinations when deemed necessary by the

Comptroller of the Currency through examiners appointed by him, the compensation of such examinations to be fixed by the Comptroller of the Currency

Any such banking corporation may go into liquidation and be closed by the vote of its shareholders owning two-thirds of its stock

Any bank doing business in the United States being the owner of stock in any Federal Reserve Bank may subscribe to the stock of any banking corporation organized under the provisions of this section, but the aggregate of such stock held by any one bank shall not exceed ten per centum of the capital stock of the subscribing bank

APPENDIX II

REVISED DRAFT OF GLASS BILL¹

H R
In the House of Representatives
1913

Mr Glass of Virginia introduced the following bill which was referred to the Banking and Currency Committee and ordered to be printed

A BILL
To provide an elastic currency, furnish means of rediscounting commercial paper, and establish a more effective supervision of banking in the United States

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled

SEC 1 The short title of this Act shall be the "Federal Reserve Act"

SEC 2 That within sixty days after the passage of this act, the Secretary of the Treasury, the Attorney-General of the United States and the Comptroller of the Currency, acting as a "Reserve Bank Organization Committee" shall designate from among the reserve cities now authorized by law a number of such cities to be determined by the said Organization Committee, and shall divide the Continental United States into districts, each district to contain one of the said reserve cities designated by the Organization Committee hereinbefore established, Provided, that the districts shall be apportioned with due regard to the convenience and customary course of business of the community, and shall not necessarily coincide with the area of such State or States as may be wholly or in part included in any given district The districts thus created may be readjusted, and new districts may from time to time be created by the Federal Reserve Board hereinafter established, acting upon a joint application made by not less than ten national banks situated within one of the existing districts, and

¹ As modified up to about May 1 at conferences during the spring of 1913 Various drafts of the more important sections of the bill were made and discussed from time to time, the text being always brought back as near as possible to the original

representing at least 10 per cent of the national bank capital of such district. The districts thus constituted shall be known as "Federal Reserve Districts" and shall be designated by number according to the pleasure of the Organization Committee hereinbefore provided for.

The Organization Committee shall in accordance with regulations to be established by itself proceed to organize in each of the reserve cities designated as hereinbefore specified a Federal Reserve Bank. Each such Federal Reserve Bank shall include in its title the name of the city in which it is situated,—as "Federal Reserve Bank of Chicago," etc.

The total number of reserve cities designated by the Organization Committee as hereinbefore provided shall not be less than 15, and in determining the said number, the Organization Committee hereinbefore created shall be authorized to take testimony, to send for persons and papers, to administer oaths, and to make such investigations as may be deemed necessary by said Committee for the purpose of determining the number of the reserve cities to be designated as herein provided.

Every National Bank located within a given district shall be required to subscribe to the capital stock of the Federal Reserve Bank of that district a sum equal to 20 per centum of its own paid up and unimpaired capital, one half of such subscription to be paid in under the terms and conditions prescribed by the National Banking Act with reference to subscriptions to the stock of National Banking Associations. The remainder of the subscriptions or any part thereof shall become a liability of the subscriber subject to call and payment thereof whenever necessary to meet the obligations of the Federal Reserve Bank under such terms and in accordance with such regulations as the Board of Directors of said Federal Reserve Bank may prescribe, Provided, that no Federal Reserve Bank shall be organized with a paid up and unimpaired capital at the time of beginning business in amount less than \$5,000,000. The Organization Committee hereinbefore provided for shall have power to appoint such assistants and incur such expenses in carrying out the provisions of this act as it shall deem necessary, and such expenses shall be payable by the Treasury of the United States upon voucher approved by the Secretary of the Treasury.

SEC 3 That the capital stock of each Federal Reserve Bank shall be divided into shares of \$100. The outstanding capital stock shall be increased from time to time as subscribing banks increase their capital or additional banks become subscribers, and shall be decreased as subscriber banks reduce their capital or leave the organization by liquidation. If a Federal Reserve Bank may establish branch offices at a point within its Federal Reserve district in which it is located approved by the Federal Reserve Board, after selection by the Board of Directors of said bank corporation, Provided, That the total number of such branches shall not exceed one for each \$500,000 of the capital stock of said Federal Reserve Bank.

SEC 4 That upon duly making and filing with the Comptroller of

Currency a certificate in the form required and described in sections 5134, 5135, and 5136, R S, U S, The National Banking Associations uniting to form a Federal Reserve Bank shall become a body corporate and as such and in the name designated in the organization certificate shall have power to perform all those acts and to enjoy all those privileges and to exercise all those powers described in section 5136, Revised Statutes, save in so far as the same shall be limited or extended as the case may be, by the provisions of this act

Every Federal Reserve Bank shall be organized and conducted under the oversight and control of a Board of Directors, whose powers shall be the same as those conferred upon the Boards of Directors of National Banking Associations under existing law, except in so far as expressly provided to the contrary in this act. Such Board of Directors shall be constituted and elected as hereinafter specified and shall consist of fifteen members holding office for three years and divided into three classes designated as class A, B and C

Class A shall consist of five members who shall be chosen by and be representative of the stockholding banks

Class B shall consist of five members who shall be chosen by and be representative of the stockholders of the National Banks holding shares in the Federal Reserve Bank

Class C shall consist of five members, four of whom shall be chosen by the Directors of classes A and B with the approval of the Federal Reserve Commission hereinafter created and one of whom shall be designated by the Federal Reserve Commission. Directors of class C shall be regarded as representative of general public interests

Directors of class A shall be chosen in the following manner

It shall be the duty of the Chairman of the Board of Directors of the Federal Reserve Bank of the district in which each such bank is situated to classify the banks of the said district who are stockholders in the said Federal Reserve Bank into five general groups or divisions. Each such group shall contain as nearly as may be one-fifth of the aggregate banking capital of the banks holding stock in the Federal Reserve Bank of the said district and shall consist of banks belonging as nearly as may be to the same general classes of capitalization. The said groups shall be designated by number at the pleasure of the Chairman of the Federal Reserve Bank

At a regularly called directors' meeting of each National Bank in the Federal Reserve District aforesaid, the Board of Directors of such National Bank shall elect by ballot one of its own members as a District Reserve Elector and shall certify his name to the Chairman of the Board of Directors of the Federal Reserve Bank of the district. The said Chairman shall establish complete lists of the District Reserve Electors, class A, thus named by banks in each of the aforesaid five groups and shall transmit one complete list to each such elector in each group. Every elector shall within fifteen days of the receipt of the said list, select and certify to the said

Chairman from among the names on the list pertaining to his group, transmitted to him by the chairman, one name as representing his choice for Federal Reserve Director, class A. The name receiving the greatest number of votes, not less than a majority, shall be designated by said Chairman as Federal Reserve Director, for the group to which he belongs. In case no candidate shall receive a majority of all votes cast in any district, the Chairman aforesaid shall establish an eligible list, including the three names receiving the greatest number of votes on the first ballot, and shall transmit said list to the electors in each of the groups of banks established by him. Each elector shall at once select and certify to the said Chairman from among the three names submitted to him his choice for Federal Reserve Director class A, and the name receiving the greatest number of such votes shall be designated by the Chairman as Federal Reserve Director class A.

Directors of class B shall be chosen in the following manner:

At an annual election of officers of each National Bank the stockholders of said bank, if there be a vacancy among directors of class B in the group to which said bank may belong, shall choose one of their own number who shall not be either an officer or director of any bank as a District Reserve Elector class B. The name of said District Reserve Elector shall be certified to the Chairman of the Board of Directors of the Federal Reserve Bank of the district in which such National bank is located. It shall thereupon be the duty of said Chairman to establish lists of said electors and to secure the selection of one director representing each of the five groups into which the banks of the district are divided from among the District Reserve Electors of class B, after the manner hereinbefore prescribed for the choice of Directors of class A.

Directors of class C shall be chosen in the following manner:

On the first day of July in each year when there shall be a vacancy among Directors of class C, the Directors of classes A and B of each Federal Reserve Bank shall, at a meeting called for that purpose, select one or more additional directors not to exceed four in number. Such additional directors shall be residents of the Federal Reserve district in which they are chosen and shall be fairly representative of the agricultural, industrial, and commercial interests of said district. None of such directors shall be during his term of office an officer or director of any other bank or banking corporation. Eight votes shall be necessary to the choice of each such director and before he shall be declared elected he shall be certified to the Secretary of the Treasury who with the advice and consent of the Federal Reserve Commission hereinafter created may accept or reject any or all such directors of class C.

A fifth director belonging to class C shall be chosen directly by the Federal Reserve Commission hereinafter created, under such regulations as it may prescribe. The said director shall be chairman of the Board of Directors of the Federal Reserve Bank of the district to which he is appointed and shall be designated as "Federal Reserve Agent." In addition

to his duties as chairman of the board of directors of the Federal Reserve Bank of the district to which he is appointed, he shall be required to maintain under regulations to be established by the Federal Reserve Commission a local office of said Commission which shall be situated on the premises of the Federal Reserve Bank of the district. He shall make regular reports to the Federal Reserve Commission, and shall act as its official representative for the performance of the functions conferred upon it by this act. He shall be paid an annual compensation to be fixed by the Federal Reserve Commission and to be paid him monthly by the Federal Reserve Bank to which he is designated.

The Reserve Organization Committee hereinbefore created may in organizing Federal Reserve Banks for the first time, call such meetings of bank directors or stockholders in the several districts as may be necessary to carry out the purposes of this act and may exercise the functions hereby conferred upon the chairman of the board of directors of each Federal Reserve Bank, pending the complete organization of such bank.

At the first meeting of the full board of directors of each Federal Reserve Bank subsequent to the organization of such bank it shall be the duty of each of the three classes of directors hereinbefore created to designate by such method as shall be prescribed by the Federal Reserve Commission one of its members whose term of office shall expire at the end of one year from the first of January nearest the date of such meeting, one whose term of office shall expire at the end of two years from said date, one whose term of office shall expire at the end of three years from said date, one whose term of office shall expire at the end of four years from said date, and one whose term of office shall expire at the end of five years from said date. Thereafter every director of a Federal Reserve Bank chosen as hereinbefore provided shall hold office for a term of five years. Provided, That the chairman of the board of directors of each Federal Reserve Bank, designated by the Federal Reserve Commission as hereinbefore described shall be removable at the pleasure of the said Commission without notice, and his successor shall hold office during the unexpired term of the director in whose place he was appointed.

SEC 5 That shares of the capital stock of Federal Reserve Banks shall not be transferable, and under no circumstances shall they be hypothecated nor shall they be owned otherwise than by subscribing banks, nor shall they be owned by any bank other than in the proportion herein provided. In case a subscribing bank increases its capital, it shall thereupon subscribe for an additional amount of capital stock of the Federal Reserve Bank of its district equal to twenty per centum of the Bank's own increase of capital, paying therefore the then book value of the shares of the Reserve Bank shown by the last published statement of said Bank. A bank applying for stock in a Federal Reserve Bank at any time after the formation of the latter must subscribe for an amount of capital of said Reserve Bank equal to twenty per centum of the capital of said subscribing bank, paying therefor

its then book value as shown by the last published statement of said Reserve Bank. When the capital of any Federal Reserve Bank has been increased either on account of the increase of capital of the banks holding stock therein or on account of the increase in the number of stockholding banks, the board of directors shall make and execute a certificate showing said increase in capital, the amount paid in and by whom paid. This certificate shall be filed in the office of the Comptroller of the Currency. In case a subscribing bank reduces its capital it shall surrender a proportionate amount of its holdings in the capital of said Federal Reserve Bank, and if a bank goes into voluntary liquidation it shall surrender all of its holdings of the capital of said Federal Reserve Bank. In either case the shares surrendered shall be cancelled and the bank shall receive in payment therefor a sum equal to their then book value as shown by the last published statement of said Federal Reserve Bank.

SEC 6 That if any shareholder of a Federal Reserve Bank shall become insolvent and a receiver be appointed, the stock held by it in said Federal Reserve Bank shall be cancelled, and the balance after paying all debts due by such insolvent bank to said Federal Reserve Bank shall be paid to the receiver of the insolvent bank. Whenever the capital stock of a Federal Reserve Bank is reduced, either on account of a reduction in capital of the banks holding its stock or of the liquidation or insolvency of any such bank holding stock therein, the Board of Directors shall make and execute a certificate showing such reduction of capital stock and the amount repaid to each bank. This certificate shall be filed in the office of the Comptroller of the Currency.

SEC 7 The earnings of each Federal Reserve Bank shall be disposed of in the following manner:

After the payment of all expenses and taxes, the shareholders shall be entitled to receive an annual dividend of five per centum on the paid in capital, which dividend shall be cumulative. Further annual net earnings shall be disposed of as follows: First, a contingent fund shall be created, which shall be maintained at an amount equal to one per centum on the paid in capital, and shall be used to meet any possible losses. Such fund shall, upon the final dissolution of a Federal Reserve Bank be paid to the United States and shall not under any circumstances be included in the book value of the stock or be paid to the shareholders. Second, one-half of additional net earnings shall be paid into the surplus fund of each Federal Reserve Bank until said fund shall amount to twenty per cent of the paid in capital of such Bank, and the remaining one-half shall be paid to the United States, and whenever and so long as the surplus fund of such Federal Reserve Banks amounts to twenty per centum of the paid in capital and the shareholders shall have received the dividends at the rate of five per centum per annum hereinbefore provided for, all excess earnings shall be paid to the United States.

SEC 8 That any National Banking Association heretofore organized

may at any time within one year from the passage of this Act, and with the approval of the Comptroller of the Currency, be granted, as herein provided, all the rights, and be subject to all the liabilities, of National Banking Associations organized subsequent to the passage of this act *Provided*, That such action on the part of such Associations shall be authorized by the consent in writing of shareholders owning not less than two-thirds of the capital stock of the Association Any National Banking Association now organized which shall not, within one year after the passage of this act, become a National Banking Association under the provisions hereinbefore stated, or which shall fail to comply with any provisions of this act, shall be dissolved, but such dissolution shall not take away or impair any remedy against such corporation, its stockholders or officers, for any liability or penalty which shall have previously been incurred

SEC 9 That any bank or banking association incorporated by special law of any State of the United States, or organized under the general laws of any State of the United States, and having a paid up unimpaired capital sufficient to entitle it to become a National Banking Association under the provisions of this act, may, by the consent in writing of the shareholders owning not less than two-thirds of the capital stock of such bank or banking association, and with the approval of the Comptroller of the Currency, become a National Banking Association under its former name or by any name approved by the Comptroller The Directors thereof may continue to be the directors of the association so organized until others are elected or appointed in accordance with the provisions of the law When the Comptroller has given to such bank or banking association a certificate that the provisions of this act have been complied with, such bank or banking association, and all its stockholders, officers and employees, shall have the same powers and privileges, and shall be subject to the same duties, liabilities, and regulations, in all respects, as shall have been prescribed for associations originally organized as National Banking Associations under this act

SEC 10 That subsequent to a date one year from the passage of this act, any bank or banking association or trust company incorporated by special law of any State, or organized under the general laws of any State of the United States, may make application to the Federal Reserve Board hereinafter created for the right to subscribe to the stock of the Federal Reserve Bank organized within the Federal Reserve district in which such local bank or banking association or trust company exists The Federal Reserve Board may at its discretion, subject to the provisions of this section, entitle such applying bank to become a stockholder in the Federal Reserve Bank of the district in which such applying bank is located, or at its discretion may reject such application Whenever the Federal Reserve Board may entitle such an applying bank to become a stockholder in the Federal Reserve Bank of the district in which the applying bank is located, stock shall be issued and paid for under the rules and regulations in this act

provided for national banks which become stockholders in Federal Reserve Banks

It shall be the duty of the Federal Reserve Board to establish by-laws for the general government of its conduct in acting upon applications made by the state banks and banking associations and trust companies hereinbefore referred to for stock ownership in Federal Reserve Banks. Such by-laws shall require of applying banks not organized under Federal law that they comply with the reserve requirements and submit to the inspection and control provided in this act or in the National Banking Act, or in any other statute of the United States applicable to National Banking Associations. No such applying bank shall be admitted to stock ownership in a Federal Reserve Bank unless it possesses a paid up unimpaired capital sufficient to entitle it to become a National Banking Association in the place where it is situated, under the provisions of the National Banking Act, and unless it in every respect conforms to the provisions of the National Banking Act and the provisions herein prescribed for National Banking Associations of similar capitalization, organized in the localities where such applying banks are situated, and holding stock in a Federal Reserve Bank.

If at any time it shall appear to the Federal Reserve Board that a banking association or trust company organized under the laws of any State of the United States has failed to comply with the provisions of this section, it shall be within the power of the said Board to require such banking association to surrender its stock in the Federal Reserve Bank in which it holds shares, upon receiving from such bank the then book value of the said shares in current funds and said Federal Reserve Bank shall upon notice from the Federal Reserve Board be required to suspend the designated banking association from further privileges of rediscount, and shall within thirty days of such notice cancel and retire its shares, and make payment therefor in the manner herein provided.

SEC 11 That there shall be created a Federal Reserve Commission, which shall consist of three classes of members hereinafter designated as classes A, B and C.

Class A shall consist of Federal Reserve Representatives, chosen by Federal Reserve Banks.

Class B shall consist of Government Reserve Representatives who shall be members ex officio of the Federal Reserve Commission.

Class C shall consist of Government Reserve Officers chosen by the President of the United States, and acting in the interest of the general public.

Federal Reserve Representatives (Class A) shall be chosen by ballot by the directors of Federal Reserve Banks at a regular directors' meeting called for that purpose. Each Federal Reserve Bank shall be entitled to choose two Representatives. One such Representative shall himself be a member of the directorate of the Federal Reserve Bank he represents, and

one shall be a resident of the Federal Reserve District from which he is chosen, and shall not be at the time of his choice or during his term of office an officer or director in any bank or banking institution. The Chairman of the Board of Directors of each Federal Reserve Bank shall be ineligible for election as a member of the Federal Reserve Commission.

Government Reserve Representatives (class B) shall be three in number and shall include the Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency.

Government Reserve Officers (class C) shall be nominated by the President of the United States and shall be confirmed by the Senate. They shall be three in number, and shall not be officers or directors of any Federal Reserve Bank. The term of office of the Government Reserve Officers shall be ten years.

Upon assembling for the first time, the members of the Federal Reserve Commission belonging to class A shall separate into two groups under such regulations as the Commission shall lay down for effecting the said grouping. One such group shall hold office for three years dating from the first of January next succeeding the election of members, the other for six years succeeding such election. Each group shall include as nearly as may be, one half the total number of members of class A. Thereafter every member of the said Commission belonging to class A shall hold office for a term of six years. Vacancies in class A shall be filled as they may occur, in the manner prescribed for the original choice of members belonging to the class in which such vacancies occur.

The Federal Reserve Commission, hereinbefore established, shall elect from among the members of class A a president, vice-president, secretary, and such other officers as may be required by by-laws which shall be drawn up and adopted by the said Commission for the government and control of its transactions. It shall have power to levy semi-annually upon the Federal Reserve Banks hereinbefore established an assessment sufficient to pay its estimated expenses for the half year succeeding the laying of such assessment together with any deficit carried forward from the preceding half year. The Federal Reserve Board hereinafter created shall semi-annually report to the Federal Reserve Commission an estimate of its expenses for the coming half year and said expenses shall be assessed upon the Federal Reserve Banks by the said Commission simultaneously with its own estimated expenses.

Each member of the Federal Reserve Commission shall receive an annual salary of \$2,500 and such allowance for necessary expenses as may be fixed by the said Commission.

The Federal Reserve Commission shall fix the compensation of the members of the Federal Reserve Board hereinafter created.

SEC. 12 That the first meeting of the Federal Reserve Commission shall be held in Washington, D. C., as soon as may be after the passage of this

act, and after the organization of Federal Reserve Banks in the several districts as herein provided, at a date to be fixed by the Reserve Organization Committee hereinbefore created

At the said meeting the members of the Federal Reserve Commission belonging to class A shall choose from among their own number by ballot three members no two of whom shall have been originally selected by the same Federal Reserve Bank. At least one of such members shall have been originally selected from the directorate of a Federal Reserve Bank and at least one shall have been selected from outside such directorate in the manner hereinbefore provided

The three members thus chosen from among the members of class A of the Federal Reserve Commission shall, with the members of classes B and C constitute a body of nine members which shall be known as the Federal Reserve Board. The Secretary of the Treasury shall be ex officio chairman of the said Federal Reserve Board. Members of the said Board shall continue to hold office until the expiration of their terms as members of the Federal Reserve Commission as hereinbefore provided. No member of class A of the Federal Reserve Commission who shall be chosen a member of the Federal Reserve Board shall continue to hold office or to act as a director of any bank or banking institution or Federal Reserve Bank, and before entering upon his duties as a member of the Federal Reserve Board he shall certify under oath to the Secretary of the Treasury that he has complied with the requirements of this section by withdrawing from any official or directoral relation of the kind herein referred to. Whenever a vacancy shall occur among the three members of the Federal Reserve Board who are chosen from among the members of class A, a successor shall within thirty days be chosen to fill the vacancy aforesaid by the method hereinbefore specified for the original choice and when chosen the said successor shall hold office for the unexpired term of the member whose place he is selected to fill

SEC 13 That the Federal Reserve Commission hereinbefore established shall at its regular quarterly meeting receive reports from the Federal Reserve Board with reference to the banking transactions of the Federal Reserve Banks during the preceding quarter, and shall be authorized to request from the Federal Reserve Board such additional information as may in the judgment of the said Commission be desirable. The Federal Reserve Board shall at the quarterly meetings aforesaid give a summary account of the actions taken by it during the three months preceding such meetings and may propound general questions relating to the state of credit, or the management of Federal Reserve Banks for consideration by the said Commission

The Federal Reserve Commission shall appoint a Board of Examiners consisting of three members which shall be authorized to report to it at any time upon the conditions of credit, the kind of business done, and the

proper conduct of the discount operations at each Federal Reserve Bank or at any individual bank, and said Commission may authorize the employment of suitable assistance, if needed, for the performance of the work of examination hereinbefore specified

At all meetings of the Federal Reserve Commission, a quorum shall consist of two-thirds of its total number of members. A majority of those present shall be required to pass any resolution. Upon motion of any member the commission may consider the resolution recommending to the Federal Reserve Board its line of conduct or of policy in regard to the performance of functions hereinbefore assigned to the said Board.

SFC 14 That section 324 of the Revised Statutes of the United States be amended so as to read as follows: "There shall be in the Department of the Treasury a Bureau charged, except as in this act otherwise provided, with the execution of all laws passed by Congress relating to the issue and regulation of currency issued by National Banking Associations, the chief officer of which Bureau shall be called the Comptroller of the Currency, and shall perform his duties under the general direction of the Secretary of the Treasury, acting as the Chairman of the Federal Reserve Board."

SEC 15 That the Federal Reserve Board hereinbefore established shall be authorized and empowered

(a) To examine at its discretion the accounts and books of each Federal Reserve Bank

(b) To determine the apportionment of Federal deposits among the Federal Reserve Banks, and to fix rates of interest thereon at its discretion

(c) To require, or on application to permit, a Federal Reserve Bank to rediscount the paper of any other Federal Reserve Bank

(d) To ascertain once each month the character of the paper held by each Federal Reserve Bank, and to require at its discretion the suspension of further issues of circulating notes for a designated period

(e) To establish each week or as much oftener as required a rate of discount which shall be mandatory upon each Federal Reserve Bank and for each class of paper, Provided, that said rate of discount need not be uniform for all Federal Reserve Banks

(f) To suspend for a period not exceeding thirty days (and to renew such suspension for periods not to exceed fifteen days) any and every reserve requirement specified in this act, Provided, that whenever such suspension may be authorized the Federal Reserve Board hereinbefore established shall have power to impose a graduated tax to be fixed at its discretion upon the amount by which reserves of Federal Reserve Banks are permitted to fall below the requirements hereinafter set forth

(g) To perform the duties and functions specified in detail in sections — — of this act

(h) To add to the number of cities classified as reserve and central reserve cities under existing law in which National Banking Associations

are subject to the reserve requirements set forth in section — of this act, or to reclassify existing reserve and central reserve cities and to designate the banks therein situated as country banks at its discretion

SEC 16 That any Federal Reserve Bank may receive from any of its stockholders deposits of current funds in lawful money, national bank notes, federal reserve notes or checks, drafts and other claims upon solvent banks, domestic and foreign

Upon the endorsement of any bank having a deposit with it, any Federal Reserve Bank may discount notes and bills of exchange arising out of commercial transactions, that is notes and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, the Federal Reserve Board to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this act, provided, that such definition shall not include notes or bills issued or drawn for the purpose of carrying or trading in stocks, bonds or other investment securities, except notes or bills having a maturity of not exceeding four months and secured by United States bonds and bonds issued by any State, county or municipality of the United States. Notes and bills admitted to discount under the terms of this paragraph must have a maturity of not more than forty-five days

Upon the endorsement of any bank having a deposit with it, any Federal Reserve Bank may discount paper of the classes hereinbefore described, having a maturity of more than forty-five and not more than 120 days, provided that its own cash reserve exceeds $33\frac{1}{3}\%$ of its total outstanding demand liabilities and provided further that not more than 50 per centum of the total paper so discounted for any depositing bank shall have a maturity of more than sixty days

Upon the endorsement of any bank having a deposit with it, any Federal Reserve Bank may discount acceptances of depositing banks which are based on the exportation or importation of goods or on travelers' credits and which mature in not more than ninety days and bear the signature of at least one bank in addition to that of the acceptor. The amount so discounted shall at no time exceed one-half the capital of the bank for which the rediscounts are made. The aggregate of such notes and bills bearing the signature or endorsement of any one person, company, firm or corporation, rediscounted for any one bank, shall at no time exceed 10 per centum of the unimpaired capital and surplus of said bank

Any National Bank may at its discretion accept drafts or bills of exchange drawn upon it having not more than four months to run and growing out of the transactions involving the importation or exportation of goods or the issue of travelers' letters of credit, provided, that no bank shall accept such bills to an amount equal in the aggregate to more than one half the face value of its paid up and unimpaired capital

SEC 17 Whenever in the opinion of the Federal Reserve Board upon

application jointly and directly made to the Secretary of the Treasury by not less than ten National Banks in one district the public interest so requires, the Federal Reserve Board may authorize the Reserve Bank of the district to discount the direct obligations of depositing banks secured by the pledge and deposit with it of satisfactory securities, but in no case shall the amount so loaned by a Federal Reserve Bank exceed three-fourths of the actual value of the securities so pledged, or one half the amount of its own paid up and unimpaired capital

SEC 18 That any Federal Reserve Bank may at its own discretion purchase in the open market either from domestic or foreign banks or individuals, bankers' bills and bills of exchange of the kinds and maturities by this act made eligible for rediscount and satisfactory commercial paper

Every Federal Reserve Bank shall have power both at home and abroad to deal in gold coin and bullion, to make loans thereon, and to contract for loans of gold coin or bullion, giving therefor, when necessary, acceptable security, including the hypothecation of its holdings, if any, of United States bonds

Every Federal Reserve Bank may invest in United States bonds, also in obligations, having not more than one year to run, of the United States or its dependencies, or of any state, or of foreign governments

Every Federal Reserve Bank shall have power to purchase from depositing banks and to sell with or without its endorsement, notes, drafts, or bills of exchange, arising out of commercial transactions as heretofore defined, payable in such foreign countries as the Board of Directors of such Federal Reserve Bank may determine These bills of exchange must have not exceeding ninety days to run and must bear the signature of two or more responsible parties, of which the last shall be that of a subscribing bank

SEC 19 That any Federal Reserve Bank may with the consent of the Federal Reserve Board open and maintain banking accounts in foreign countries and establish agencies in such countries wheresoever it may deem best for the purpose of purchasing, selling and collecting foreign bills of exchange, and it shall have authority to buy and sell with or without its endorsement through such correspondents or agencies, checks or prime foreign bills of exchange arising out of commercial transactions, which have not exceeding ninety days to run, and which bear the signature of two or more responsible parties

SEC 20 That all moneys now held in the general fund of the Treasury shall within twelve months of the passage of this act be deposited in Federal Reserve Banks, and thereafter the revenues of the Government shall be regularly deposited in such banks and disbursements shall be made by checks drawn against such deposits

The Federal Reserve Board shall, as heretofore provided, apportion the funds of the Government among the said Federal Reserve Banks, and may at its discretion fix from month to month a rate of interest which shall

be regularly paid by the banks holding such deposit, provided, that no Federal Reserve Bank shall pay interest upon any deposits except those of the United States

SEC 21 That the Government of the United States and the banks depositing in the Federal Reserve Banks formed in accordance with the provisions of this act shall be the only depositors in said Reserve Banks All domestic transactions of the Federal Reserve Banks involving the creation of deposit accounts shall be confined to the Government and the depositing banks, with the exception of the purchase or sale of Government or State securities, or securities of foreign governments, or of gold coin or bullion

SEC 22 That no National Banking Association shall be entitled to receive from the Comptroller of the Currency, or to issue, circulating notes in excess of the total amount of such notes which such bank may have outstanding at the passage of this act Provided, that no National Banking Association which may in future reduce its outstanding circulating notes in the manner prescribed by law shall hereafter be entitled to receive from the Comptroller of the Currency, or to issue, circulating notes in excess of the sum to which its outstanding notes shall have been reduced by such withdrawals

SEC 23 That so much of the provisions of section 5159 of the Revised Statutes of the United States and section 4 of the Act of June 20th, 1874, and section 8 of the Act of July 12th, 1882, and of any other provisions of existing statutes as require that before any National Banking Association shall be authorized to commence banking business it shall transfer and deliver to the Treasurer of the United States, United States registered bonds, to an amount, where the capital is \$150,000 or less, not less than one-fourth of its capital stock, and \$50,000 where the capital is in excess of \$150,000, be and the same is hereby repealed

SEC 24 Upon application, the Secretary of the Treasury shall exchange the two per centum bonds of the United States bearing the circulation privilege, theretofore deposited by any National Banking Association with the Treasurer of the United States as security for circulating notes, for three per centum bonds of the United States without the circulation privilege, payable after twenty years from date of issue, and exempt from Federal taxation both as to income and principal When and in proportion as the outstanding two per centum bonds deposited with the Treasurer shall be thus exchanged or refunded, the power of National Banks to issue circulating notes secured by United States bonds shall cease and determine Every National Bank may continue to apply for and receive from the Comptroller of the Currency circulating notes under the conditions provided by this act, but no National Bank shall be permitted to issue circulating notes of any description or to issue or to make use of any substitute for such circulating notes in the form of Clearing House certificates, cashier's checks or other obligation not specifically provided for under this

act, Provided, That no National Bank shall without consent of the Secretary of the Treasury in any one year present two per centum bonds for exchange in the manner hereinbefore provided to an amount exceeding five per centum of the total amount of bonds deposited with the Treasurer by said bank at the time of the passage of this act, Provided further that the expiration of twenty years from the passage of this act every holder of United States 2 per centum bonds then outstanding shall receive in exchange three per centum bonds of like denomination payable twenty years from date of issue, and without the circulation privilege After twenty years from the date of the passage of this act national bank notes still remaining outstanding shall be recalled and redeemed by the National Banking Associations issuing the same within a period and under regulations to be prescribed by the Federal Reserve Board and notes still remaining in circulation at the end of such period shall be backed by an equal amount of lawful money deposited in the Treasury of the United States by the Banking Associations originally issuing such notes

SEC 25 That within sixty days from and after the date when the Secretary of the Treasury shall have officially announced in such manner as he shall select to National Banks situated in the several Federal Reserve districts the fact that a Federal Reserve Bank has been established in the district in which each such bank is situated, every such National Banking Association wherever situated within said districts shall establish with the Federal Reserve Bank of that district a credit balance on the books of the latter institution equal to not less than 5 per centum of the total demand liabilities, exclusive of circulating notes, of the National Banking Association establishing the same Such balance may at any time be increased but shall at no time be allowed to fall below a figure equal to the 5 per cent of outstanding deposit liabilities aforesaid

From and after the date set by the Secretary of the Treasury and officially announced by him as hereinbefore provided, it shall be the duty of National Banking Associations now classified as country banks and situated outside of central reserve and reserve cities to maintain a reserve equal to 15 per centum of the aggregate amount of their deposits Such reserve shall consist to the extent of one third of lawful money held actually in the vaults of the banking office of each such National Banking Association, and to the extent of at least one third of current funds or balances due to such Associations by the Federal Reserve Bank of the district in which such Association is situated, from and after the date upon which the National Banking Association in question shall have become a depositor in the Federal Reserve Bank aforesaid The remaining one third of the 15 per cent reserve hereinbefore required, may for a period of fourteen months, from and after the date set by the Secretary of the Treasury as hereinbefore provided consist of balances due to an Association from Associations organized under the National Banking Act in reserve or central reserve

cities as now defined by law From and after a date fourteen months subsequent to the date set by the Secretary of the Treasury as hereinbefore provided, the said one-third of the fifteen per cent reserve required of country banks shall consist either of lawful money in its own vaults or of balances due to it and carried on the books of the Federal Reserve Bank of the district in which such Banking Association is situated

From and after the date set by the Secretary of the Treasury as hereinbefore provided for a period of fourteen months it shall be the duty of National Banking Associations now classified as reserve city banks and situated in existing reserve cities, to maintain a reserve equal to 25 per centum of the aggregate amount of their outstanding deposits For a period of twelve months from the expiration of the fourteen months aforesaid, it shall be the duty of said National Banking Associations to maintain a reserve equal to $22\frac{1}{2}$ per cent of their outstanding deposits and from and after the expiration of said period of twelve months last aforesaid it shall be the duty of said National Banking Associations to maintain a reserve equal to 20 per cent of their outstanding deposits Every such National Banking Association shall for a period of sixty days after the date set by the Secretary of the Treasury as hereinbefore provided maintain constantly on hand in its own vaults in lawful money a sum equal to $12\frac{1}{2}$ per cent of its outstanding deposits, and subsequent to the expiration of the said sixty days and at all times thereafter, a sum equal to 10 per cent of its outstanding deposits, the aforesaid 10 per cent and $12\frac{1}{2}$ per cent respectively, constituting a part of and being included in the twenty-five per cent reserve, the $22\frac{1}{2}$ per cent reserve, and the 20 per cent reserve hereinbefore required For a period of twenty-six months from and after the date set by the Secretary of the Treasury as hereinbefore provided, the net difference between the reserve required to be maintained in lawful money in the vaults of National Banking Associations situated in reserve cities plus the deposit balance to the credit of such Associations on the books of the Federal Reserve Bank of the districts in which they are situated and the total amount of reserve required to be held by such Associations, may consist of balances of current funds carried with National Banking Associations in cities now designated as central reserve cities Each such difference may at the discretion of a National Banking Association be kept in lawful money in its own vaults, or may consist of balances with the Federal Reserve Bank of the district in which such Association is situated From and after a date twenty-six months subsequent to the date set by the Secretary of the Treasury as hereinbefore provided, the required reserve of each such National Banking Association shall consist of lawful money in its own vaults or of balances of current funds with the Federal Reserve Bank of the district in which it is situated, and balances kept by it with National Banking Association in central reserve cities shall not be counted or reported

as a part of the required reserve of National Banking Associations in reserve cities

From and after the date set by the Secretary of the Treasury as hereinbefore provided, for a period of fourteen months, it shall be the duty of National Banking Associations now classified as central reserve city banks and situated in existing central reserve cities to maintain a reserve equal to 25 per cent of the aggregate amount of their outstanding deposits. For a period of twelve months from the expiration of the fourteen months aforesaid, it shall be the duty of said National Banking Associations to maintain a reserve equal to 22½ per cent of their outstanding deposits. From and after the expiration of the period of twelve months last aforesaid, it shall be the duty of said National Banking Associations to maintain a reserve equal to twenty per cent of their outstanding deposits. Every such National Banking Association shall for a period of sixty days after the passage of this act maintain constantly on hand in its own vaults in lawful money a sum equal to twenty per cent of its outstanding deposits, and subsequent to the expiration of the said sixty days and at all times thereafter a sum in lawful money equal to at least ten per centum of its outstanding deposits. The net difference between the minimum amount of lawful money actually required to be held in the vaults of said National Banking Associations situated in central reserve cities and the total amount of required reserve as hereinbefore specified may consist of balances due from the Federal Reserve Bank of the district in which such Associations are situated, or of lawful money actually held in the vaults of such Associations in addition to the required minimum hereinbefore specified, Provided, That the net balance to the credit of such Associations on the books of the Federal Reserve Bank of the district in which they are situated shall at no time fall below the five per centum of outstanding deposits hereinbefore required to be established within sixty days from the passage of this act.

SEC 26 That so much of section 3 of the Act of June 20th, 1874, entitled "An Act fixing the amount of United States notes, providing for a redistribution of the National Bank Currency, and for other purposes," as provides that the fund deposited by any National Banking Association with the Treasurer of the United States for the redemption of its notes shall be counted as a part of its lawful reserve as provided in the act aforesaid be, and the same is hereby repealed. And from and after the passage of this act, such fund of five per centum shall in no case be counted by any National Banking Association as a part of its lawful reserve.

SEC 27 That every Federal Reserve Bank shall at all times have on hand in its own vaults in gold or the equivalent thereof a sum equal to not less than 25 per centum of its outstanding demand liabilities, which shall at the same time be not less than 50 per centum of its outstanding circulating notes. It shall at all times have on hand in its own vaults live commercial paper having not more than 45 days to run to an amount equal to 50 per

centum of its outstanding demand liabilities which shall at the same time be not less than 75 per centum of its outstanding circulating notes

SEC 28 That the examination of the affairs of every National Banking Association authorized by existing law, shall take place at least twice in each calendar year, and as much oftener as the Comptroller of the Currency shall consider necessary in order to furnish a full and complete knowledge of its condition The Secretary of the Treasury may, however, at any time direct the holding of a special examination The person assigned to the making of such examination of the affairs of any National Banking Association shall have power to call together a quorum of the directors of such Association, who shall, under oath, state to such examiner the character and circumstances of such of its loans or discounts as he may designate, and from and after the passage of this act all bank examiners shall receive fixed salaries, the amount whereof shall be determined by the Federal Reserve Board and shall be annually reported to Congress But the expense of the examinations herein provided for shall be assessed by the Comptroller of the Currency upon the Associations examined, in proportion to assets or resources held by such Associations upon a date during the year in which such examinations are held to be established by the Comptroller of the Currency The Comptroller of the Currency shall so arrange the duties of National Bank Examiners that no two examinations of any Association shall be made by the same Examiner

In addition to the examinations made and conducted by the Comptroller of the Currency, every Federal Reserve Bank may with the approval of the Federal Reserve Board arrange for special or periodical examination of the banks within its district Such examination shall be so conducted as to inform the Federal Reserve Bank under whose auspices it is carried on of the condition of its member or stockholding banks, and of the lines of credit which are being extended by them Every Federal Reserve Bank shall at all times be bound to furnish to the Federal Reserve Board such information as may be demanded by the latter concerning the condition of any National Banking Association organized within the district in which the said Federal Reserve Bank is located, and it shall have power at all times to order special examinations without notice, for the purpose of ascertaining the condition of its member or stockholding banks

The Federal Reserve Board shall as often as it deems best, and in any case not less frequently than four times each year, order an examination of National Banking Associations in reserve cities Such examinations shall show in detail the total amount of loans made by each bank on demand, on time, and the different classes of collateral held to protect the various loans

SEC 29 That no National Bank shall hereafter make any loan or grant any gratuity to any examiner of such Bank Any Bank offending against this provision shall be deemed guilty of a misdemeanor, and shall be fined not more than \$1,000 and a further sum equal to the money so loaned or

gratuity given, and the officer or officers of a Bank making such loan or granting such gratuity shall be likewise deemed guilty of a misdemeanor, and shall be fined not to exceed \$500. Any examiner accepting a loan or gratuity from any Bank examined by him shall be deemed guilty of a misdemeanor and shall be fined not more than \$500, and a further sum equal to the money so loaned or gratuity given, and shall forever thereafter be disqualified from holding office as a National Bank Examiner. No National Bank Examiner shall perform any other service for compensation while holding such office.

SEC 30. That from and after the passage of this act the stockholders of every National Banking Association shall be held individually responsible for all contracts, debts, and engagements of such Association, each to the amount of his stock therein, at the par value thereof in addition to the amount invested in such stock. The stockholders in any National Banking Association who shall have transferred their shares, or registered the transfer thereof, within sixty days next before the date of the failure of such Association to meet its obligations, shall be liable to the same extent as if they had made no such transfer, but this provision shall not be construed to affect in any way resources which such shareholders might otherwise have against those in whose names such shares are registered at the time of such failure.

SEC 31. That any National Banking Association not situated in a Reserve City or Central Reserve City may make loans secured by improved and unencumbered farm land, and so much of section —, Revised Statutes, as prohibits the making of such loans by banks so situated shall be and the same is hereby repealed, provided, that no such loan shall be made to an amount exceeding 50 per centum of the actual value of the property offered as security, and such properties shall be situated within the Federal Reserve District in which the said Bank is located, and provided further that the aggregate amount of such loans made by any one bank shall not exceed a sum equal to 25 per cent of the capital and surplus, unimpaired, of such bank.

The Federal Reserve Commission shall have power from time to time to add to the list of cities in which National Banks shall not be permitted to make loans secured upon real estate in the manner described in this section.

SEC 32. That any National Banking Association possessing a capital of \$1,000,000 or more may file application with the Federal Reserve Board upon such conditions and under such circumstances as may be prescribed by the said Board for the purpose of securing authorization to establish branches in foreign countries for the furtherance of the foreign commerce of the United States, and to act if required to do so as fiscal agents of the United States. Such application shall specify in addition to the name and capital of the Banking Association filing it, the foreign country or countries

or the dependencies of the United States where the banking operations proposed are to be carried on and the amount of capital set aside by the said Banking Association filing application for the conduct of its foreign business at the branches proposed by it to be established in foreign countries. The Federal Reserve Board shall have power to reject such application if in its judgment the amount of capital proposed to be set aside for the conduct of foreign business is inadequate, or if for other reasons the granting of such application is deemed inexpedient.

Every National Banking Association which shall receive authorization to establish branches in foreign countries, shall be required at all times to furnish information concerning the condition of such branches to the Comptroller of the Currency upon demand, and the Federal Reserve Board may order special examinations of the said foreign branches at such time or times as it may deem best. Every such National Banking Association shall conduct the accounts of each foreign branch independently of the accounts of other foreign branches established by it and of its home office, and shall at the end of each fiscal period transfer to its general ledger the profit or loss accruing at each such branch as a separate item.

APPENDIX III

FIRST PRINT OF THE GLASS BILL

Early in June, 1913, the Glass bill was put into print for the first time. A copy reached Secretary Bryan, as already described in the text (Chapter XIII), and became the basis of the White House Conference at which it was determined to make the Federal Reserve Board a governmental body exclusively. What were Sections 11-14 of the original print were eliminated or modified and the bill was reprinted. Earlier prints were then destroyed. Both prints were labeled "Strictly confidential." In this appendix are given Sections 11-14 as finally printed before the White House Conference, and the entire first (modified) "strictly confidential" print of the bill as it emerged.

A SECTIONS 11-14 OF THE GLASS BILL PRIOR TO MODIFICATION AT THE WHITE HOUSE

FEDERAL RESERVE COMMISSION

SEC 11 That there shall be created a Federal Reserve Commission, which shall consist of three classes of members, hereinafter designated as classes A, B, and C

Class A shall consist of Federal reserve representatives, chosen by Federal reserve banks

Class B shall consist of Government reserve representatives, who shall be members ex officio of the Federal reserve commission

Class C shall consist of Government reserve officers chosen by the President of the United States and acting in the interest of the general public

Federal reserve representatives (class A) shall be chosen by ballot by the directors of Federal reserve banks at a regular directors' meeting called for that purpose. Each Federal reserve bank shall be entitled to choose two representatives. One such representative shall himself be a member of the directorate of the Federal reserve bank he represents, and one shall be

a resident of the Federal reserve district from which he is chosen and shall not be at the time of his choice or during his term of office an officer or director in any bank or banking institution. The chairman of the board of directors of each Federal reserve bank shall be ineligible for election as a member of the Federal Reserve Commission.

Government reserve representatives (class B) shall be three in number and shall include the Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency.

Government reserve officers (class C) shall be nominated by the President of the United States and shall be confirmed by the Senate. They shall be three in number and shall not be officers or directors of any Federal reserve bank. The term of office of the Government reserve officers shall be ten years.

Upon assembling for the first time, the members of the Federal Reserve Commission belonging to class A shall separate into two groups under such regulations as the commission shall lay down for effecting the said grouping. One such group shall hold office for three years dating from the first of January next succeeding the election of members, the other for six years succeeding such election. Each group shall include, as nearly as may be, one-half the total number of members of class A. Thereafter, every member of the said commission belonging to class A shall hold office for a term of six years. Vacancies in class A shall be filled as they may occur, in the manner prescribed for the original choice of members belonging to the class in which such vacancies occur.

The Federal Reserve Commission, hereinbefore established, shall elect from among the members of class A a president, vice president, secretary, and such other officers as may be required by by-laws which shall be drawn up and adopted by the said commission for the government and control of its transactions. It shall have power to levy semiannually upon the Federal reserve banks hereinbefore established an assessment sufficient to pay its estimated expenses for the half year succeeding the laying of such assessment, together with any deficit carried forward from the preceding half year. The Federal Reserve Board hereinafter created shall semiannually report to the Federal Reserve Commission an estimate of its expenses for the coming half year, and said expenses shall be assessed upon the Federal reserve banks by the said commission simultaneously with its own estimated expenses.

Each member of the Federal Reserve Commission shall receive an annual salary of \$2,500 and such allowance for necessary expenses as may be fixed by the said commission.

The Federal Reserve Commission shall fix the compensation of the members of the Federal Reserve Board hereinafter created.

SEC 12 That the first meeting of the Federal Reserve Commission shall be held in Washington, District of Columbia, as soon as may be after the

passage of this Act, and after the organization of Federal reserve banks in the several districts as herein provided, at a date to be fixed by the reserve organization committee hereinbefore created

At the said meeting the members of the Federal Reserve Commission belonging to class A shall choose from among their own number by ballot three members no two of whom shall have been originally selected by the same Federal reserve bank. At least one of such members shall have been originally selected from the directorate of a Federal reserve bank and at least one shall have been selected from outside such directorate in the manner hereinbefore provided

FEDERAL RESERVE BOARD

The three members thus chosen from among the members of class A of the Federal Reserve Commission shall, with the members of classes B and C, constitute a body of nine members which shall be known as the Federal Reserve Board. The Secretary of the Treasury shall be ex officio chairman of the said Federal Reserve Board. Members of the said board shall continue to hold office until the expiration of their terms as members of the Federal Reserve Commission, as hereinbefore provided. No member of class A of the Federal Reserve Commission who shall be chosen a member of the Federal Reserve Board shall continue to hold office or to act as a director of any bank or banking institution or Federal reserve bank, and before entering upon his duties as a member of the Federal Reserve Board he shall certify under oath to the Secretary of the Treasury that he has complied with the requirements of this section by withdrawing from any official or directoral relation of the kind herein referred to. Whenever a vacancy shall occur among the three members of the Federal Reserve Board who are chosen from among the members of class A, a successor shall within thirty days be chosen to fill the vacancy aforesaid by the method hereinbefore specified for the original choice, and when chosen the said successor shall hold office for the unexpired term of the member whose place he is selected to fill.

SEC 13 That the Federal Reserve Commission hereinbefore established shall at its regular quarterly meeting receive reports from the Federal Reserve Board with reference to the banking transactions of Federal reserve banks during the preceding quarter, and shall be authorized to request from the Federal Reserve Board such additional information as may in the judgment of the said commission be desirable. The Federal Reserve Board shall at the quarterly meetings aforesaid give a summary account of the actions taken by it during the three months preceding such meetings and may propound general questions relating to the state of credit, or the management of Federal reserve banks for consideration by the said commission.

The Federal Reserve Commission shall appoint a board of examiners, consisting of three members, which shall be authorized to report to it at

any time upon the conditions of credit, the kind of business done, and the proper conduct of the discount operations at each Federal reserve bank or at any individual bank, and said commission may authorize the employment of suitable assistance, if needed, for the performance of the work of examination hereinbefore specified

That at all meeting of the Federal Reserve Commission a quorum shall consist of two-thirds of its total number of members. A majority of those present shall be required to pass any resolution. Upon motion of any member the commission may consider the resolution recommending to the Federal Reserve Board its line of conduct or of policy in regard to the performance of functions hereinbefore assigned to the said board

SEC 14 That section three hundred and twenty-four of the Revised Statutes of the United States be amended so as to read as follows. "There shall be in the Department of the Treasury a bureau charged, except as in this Act otherwise provided, with the execution of all laws passed by Congress relating to the issue and regulation of currency issued by national banking associations, the chief officer of which bureau shall be called the Comptroller of the Currency, and shall perform his duties under the general direction of the Secretary of the Treasury, acting as the chairman of the Federal Reserve Board"

B COMPLETE FIRST (MODIFIED) PRINT OF GLASS BILL

A BILL

To provide for the establishment of Federal reserve banks, for furnishing an elastic currency, affording means of rediscounting commercial paper, and to establish a more effective supervision of banking in the United States, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, that the short title of this Act shall be the "Federal reserve Act"

FEDERAL RESERVE DISTRICTS

SEC 2 That within ninety days after the passage of this Act, or as soon thereafter as practicable, the Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency, acting as a reserve-bank organization committee, shall designate from among the reserve cities now authorized by law a number of such cities to be determined by the said organization committee and to be known as Federal reserve cities, and shall divide the continental United States into districts, each district to contain one of such Federal reserve cities. *Provided*, That the districts shall be apportioned with due regard to the convenience and customary course of business of the community and shall not necessarily coincide with the area of such State or States as may be wholly or in part included in any given district

The districts thus created may be readjusted and new districts may from time to time be created by the Federal Reserve Board hereinafter established, acting upon a joint application made by not less than ten national banks situated within one of the existing districts. The districts thus constituted shall be known as Federal reserve districts and shall be designated by number according to the pleasure of the organization committee.

The organization committee shall, in accordance with regulations to be established by itself, proceed to organize in each of the reserve cities designated as hereinbefore specified a Federal reserve bank. Each such Federal reserve bank shall include in its title the name of the city in which it is situated, as "Federal Reserve Bank of Chicago," and so forth.

The total number of reserve cities designated by the organization committee shall be not less than twelve, and the organization committee shall be authorized to employ counsel and expert aid, to take testimony, to send for persons and papers, to administer oaths, and to make such investigations as may be deemed necessary by the said committee for the purpose of determining the number of reserve cities to be designated.

Every national bank located within a given district shall be required to subscribe to the capital stock of the Federal reserve bank of that district a sum equal to twenty per centum of its unimpaired capital, one-half of such subscription to be paid in under the terms and conditions prescribed by the national banking Act with reference to subscriptions to the stock of national banking associations. The remainder of the subscriptions or any part thereof shall become a liability of the subscribers, subject to call and payment thereof whenever necessary to meet the obligations of the Federal reserve bank under such terms and in accordance with such regulations as the board of directors of said Federal reserve bank may prescribe. *Provided*, That no Federal reserve bank shall be organized with a paid-up and unimpaired capital at the time of beginning business less in amount than \$5,000,000. The organization committee shall have power to appoint such assistants and incur such expenses in carrying out the provisions of this Act, as it shall deem necessary, and such expenses shall be payable by the Treasurer of the United States upon voucher approved by the Secretary of the Treasury, and the sum of \$100,000, or so much thereof as may be necessary, is hereby appropriated, out of any moneys in the Treasury not otherwise appropriated, for the payment of such expenses.

STOCK ISSUES

SEC 3 That the capital stock of each Federal reserve bank shall be divided into shares of \$100. The outstanding capital stock shall be increased from time to time as subscribing banks increase their capital or as additional banks become subscribers, and shall be decreased as subscribing banks reduce their capital or leave the organization. Each Federal reserve bank may establish branch offices under regulations of the Federal Reserve

Board at a point within the Federal reserve district in which it is located *Provided*, That the total number of such branches shall not exceed one for each \$500,000 of the capital stock of said Federal reserve bank

FEDERAL RESERVE BANKS

SEC 4 That upon duly making and filing with the Comptroller of the Currency a certificate in the form required and described in sections fifty-one hundred and thirty-four and fifty-one hundred and thirty-five, Revised Statutes of the United States, such Federal reserve bank shall become a body corporate and as such and in the name designated, respectively, in the organization certificate shall have power to perform all those acts and to enjoy all those privileges and to exercise all those powers described in section fifty-one hundred and thirty-six, Revised Statutes, save in so far as the same shall be limited or extended, as the case may be, by the provisions of this Act The Federal reserve bank so incorporated shall have succession for a period of twenty years from its organization, unless sooner dissolved by Act of Congress

Every Federal reserve bank shall be organized and conducted under the oversight and control of a board of directors, whose powers shall be the same as those conferred upon the boards of directors of national banking associations under existing law, except in so far as expressly provided to the contrary in this Act Such board of directors shall be constituted and elected as hereinafter specified and shall consist of nine members, holding office for three years and divided into three classes, designated as classes A, B, and C

Class A shall consist of three members, who shall be chosen by and be representative of the stock-holding banks

Class B shall consist of three members, who shall be representative of the said Federal reserve bank into three general groups or divisions Each such group shall contain as nearly as may be one-third of the aggregate banking capital of the banks holding stock in the Federal reserve bank of the said district and shall consist of banks of similar capitalization The said groups shall be designated by number at the pleasure of the chairman of the Federal reserve Board

Class C shall consist of three members, who shall be designated by the Federal Reserve Board

Directors of class A shall be chosen in the following manner

It shall be the duty of the chairman of the board of directors of the Federal reserve bank of the district in which each such bank is situated to classify the member banks of the said district who are stockholders in the said Federal reserve bank into three general groups or divisions Each such group shall contain as nearly as may be one-third of the aggregate banking capital of the banks holding stock in the Federal reserve bank of the said district and shall consist of banks of similar capitalization The said groups shall be designated by number at the pleasure of the chairman of the Federal reserve bank

At a regularly called directors' meeting of each national bank in the Federal reserve district aforesaid, the board of directors of such national bank shall elect by ballot one of its own members as a district reserve

elector and shall certify his name to the chairman of the board of directors of the Federal reserve bank of the district. The said chairman shall establish complete lists of the district reserve electors, class A, thus named by banks in each of the aforesaid three groups and shall transmit one complete list to each such elector in each group. Every elector shall, within fifteen days of the receipt of the said list, select and certify to the said chairman from among the names on the list pertaining to his group, transmitted to him by the chairman, one name as representing his choice for Federal reserve director, class A. The name receiving the greatest number of votes, not less than a majority, shall be designated by said chairman as Federal reserve director for the group to which he belongs. In case no candidate shall receive a majority of all votes cast in any district, the chairman aforesaid shall establish an eligible list, including the three names receiving the greatest number of votes on the first ballot, and shall transmit said list to the electors in each of the groups of banks established by him. Each elector shall at once select and certify to the said chairman from among the three names submitted to him his choice for Federal reserve director, class A, and the name receiving the greatest number of such votes shall be designated by the chairman as Federal reserve director, class A.

Directors of class B shall be chosen at the same time and in the same manner hereinbefore prescribed for directors of class A, except that they shall in no case be officers or directors of any bank or banking association, and shall not accept office as such during the term of their service as directors of the Federal reserve bank. They shall be fairly representative of the commercial, agricultural or industrial interests of their respective districts. The Federal Reserve Board shall have power at its discretion to remove any director of class B in any Federal reserve bank, if it should appear at any time that such director does not fairly represent the commercial, agricultural or industrial interests of his district.

Three directors belonging to class C shall be chosen directly by the Federal Reserve Board one of whom shall be designated by said board as chairman of the board of directors of the Federal reserve bank of the district to which he is appointed and shall be designated as "Federal reserve agent." In addition to his duties as chairman of the board of directors of the Federal reserve bank of the district to which he is appointed, he shall be required to maintain under regulations to be established by the Federal Reserve Board a local office of said board which shall be situated on the premises of the Federal reserve bank of the district. He shall make regular reports to the Federal Reserve Board, and shall act as its official representative for the performance of the functions conferred upon it by this Act. He shall be paid an annual compensation to be fixed by the Federal Reserve Board and to be paid him monthly by the Federal reserve bank to which he is designated.

The reserve organization committee shall, in organizing Federal reserve

banks for the first time, call such meetings of bank directors in the several districts as may be necessary to carry out the purposes of this Act and may exercise the functions herein conferred upon the chairman of the board of directors of each Federal reserve bank pending the complete organization of such bank

At the first meeting of the full board of directors of each Federal reserve bank subsequent to the organization of such bank it shall be the duty of the directors of classes A and B each to designate one of its members whose term of office shall expire in one year from the first of January nearest to date of such meeting, one whose term of office shall expire at the end of two years from said date, and one whose term of office shall expire at the end of three years from said date. Thereafter every director of a Federal reserve bank chosen as hereinbefore provided shall hold office for a term of three years but the chairman of the board of directors of each Federal reserve bank designated by the Federal Reserve Board, as hereinbefore described, shall be removable at the pleasure of the said board without notice, and his successor shall hold office during the unexpired term of the director in whose place he was appointed

INCREASE AND DECREASE OF CAPITAL

SEC 5 That shares of the capital stock of Federal reserve banks shall not be transferable, nor be hypothecated, in case a subscribing bank increases its capital, it shall thereupon subscribe for an additional amount of capital stock of the Federal reserve bank of its district equal to twenty per centum of the bank's own increase of capital, paying therefor the then book value of the shares of the reserve bank as shown by the last published statement of said bank. A bank applying for stock in a Federal reserve bank at any time after the formation of the latter must subscribe for an amount of the capital of said reserve bank equal to twenty per centum of the capital of said subscribing bank, paying therefor its then book value as shown by the last published statement of said reserve bank. When the capital of any Federal reserve bank has been increased, either on account of the increase of capital of the banks holding stock therein or on account of the increase in the number of stockholding banks, the board of directors shall make and execute a certificate showing said increase in capital, the amount paid in and by whom paid. This certificate shall be filed in the office of the Comptroller of the Currency. In case a subscribing bank reduces its capital it shall surrender a proportionate amount of its holdings in the capital of said Federal reserve bank, and if a bank goes into voluntary liquidation it shall surrender all of its holdings of the capital of said Federal reserve bank. In either case the shares surrendered shall be canceled and the bank shall receive in payment therefor a sum equal to their then book value as shown by the last published statement of said Federal reserve bank.

SEC 6 That if any shareholder of a Federal reserve bank shall become

insolvent and a receiver be appointed the stock held by it in said Federal reserve bank shall be canceled and the balance of its value, after paying all debts due by such insolvent bank to said Federal reserve bank, shall be paid to the receiver of the insolvent bank. Whenever the capital stock of a Federal reserve bank is reduced, either on account of a reduction in capital of the banks holding its stock or of the liquidation or insolvency of any such bank holding stock therein, the board of directors shall make and execute a certificate showing such reduction of capital stock and the amount repaid to each bank. This certificate shall be filed in the office of the Comptroller of the Currency.

DIVISION OF EARNINGS

SEC 7 The earnings of each Federal reserve bank shall be disposed of in the following manner:

After the payment of all expenses and taxes, the shareholders shall be entitled to receive an annual dividend of five per centum on the paid-in capital, which dividend shall be cumulative. One-half of the net earnings shall be paid into the surplus fund until said fund shall amount to twenty per centum of the paid-in capital of such bank, and the remaining one-half shall be paid to the United States, and whenever and so long as the surplus fund of such Federal reserve bank amounts to twenty per centum of the paid-in capital and the shareholders shall have received the dividends at the rate of five per centum per annum heretofore provided for, all excess earnings shall be paid to the United States.

Every Federal reserve bank incorporated under the terms of this Act shall be exempt from Federal, State, and local taxation, except in respect to taxes upon real estate.

SEC 8 That any national banking association heretofore organized may at any time within one year from the passage of this Act, and with the approval of the Comptroller of the Currency, be granted, as herein provided, all the rights, and be subject to all the liabilities, of national banking associations organized subsequent to the passage of this Act. *Provided*, That such action on the part of such associations shall be authorized by the consent in writing of shareholders owning not less than a majority of the capital stock of the association. Any national banking association now organized which shall not, within one year after the passage of this Act, become a national banking association under the provisions heretofore stated, or which shall fail to comply with any of the provisions of this Act, shall be dissolved, but such dissolution shall not take away or impair any remedy against such corporation, its stockholders or officers, for any liability or penalty which shall have previously been incurred.

SEC 9 That any bank or banking association incorporated by special law of any State or of the United States, or organized under the general laws of any State of the United States, and having an unimpaired capital suffi-

cient to entitle it to become a national banking association under the provisions of this Act, may, by the consent in writing of the shareholders owning not less than fifty-one per centum of the capital stock of such bank or banking association, and with the approval of the Comptroller of the Currency, become a national banking association under its former name or by any name approved by the comptroller. The directors thereof may continue to be the directors of the association so organized until others are elected or appointed in accordance with the provisions of the law. When the comptroller has given to such bank or banking association a certificate that the provisions of this Act have been complied with, such bank or banking association, and all its stockholders, officers, and employees, shall have the same powers and privileges, and shall be subject to the same duties, liabilities, and regulations, in all respects, as shall have been prescribed for associations originally organized as national banking associations under this Act.

STATE BANKS AS MEMBERS

SEC 10 That from and after the passage of this Act any bank or banking association or trust company incorporated by special law of any State, or organized under the general laws of any State or the United States, may make application to the Federal Reserve Board hereinafter created for the right to subscribe to the stock of the Federal reserve bank organized within the Federal reserve district where located. The Federal Reserve Board may, at its discretion, subject to the provisions of this section, entitle such applying bank to become a stockholder in the Federal reserve bank of the district in which such applying bank is located, or at its discretion may reject such application. Whenever the Federal Reserve Board may entitle such an applying bank to become a stockholder in the Federal reserve bank of the district in which the applying bank is located, stock shall be issued and paid for under the rules and regulations in this Act provided for national banks which become stockholders in Federal reserve banks.

It shall be the duty of the Federal Reserve Board to establish by-laws for the general government of its conduct in acting upon applications made by the State banks and banking associations and trust companies hereinbefore referred to for stock ownership in Federal reserve banks. Such by-laws shall require of applying banks not organized under Federal law that they comply with the reserve requirements and submit to the inspection and regulation provided in this Act. No such applying bank shall be admitted to stock ownership in a Federal reserve bank unless it possesses a paid-up unimpaired capital sufficient to entitle it to become a national banking association in the place where it is situated, under the provisions of the national banking Act, and conforms to the provisions herein prescribed for national banking associations of similar capitalization.

If at any time it shall appear to the Federal Reserve Board that a bank-

ing association or trust company organized under the laws of any State or of the United States has failed to comply with the provisions of this section, it shall be within the power of the said board to require such banking association or trust company to surrender its stock in the Federal reserve bank in which it holds shares upon receiving from such bank the then book value of the said shares in current funds, and said Federal reserve bank shall upon notice from the Federal Reserve Board be required to suspend the designated banking association or trust company from further privileges of rediscount, and shall within thirty days of such notice cancel and retire its shares and make payment therefor in the manner herein provided

FEDERAL RESERVE BOARD

SEC. 11 There shall be created a Federal Reserve Board, which shall consist of seven members, including the Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency, who shall be members ex officio, and four members chosen by the President of the United States, by and with the advice and consent of the Senate. The four members of the Federal Reserve Board chosen by the President and confirmed as aforesaid shall each receive an annual salary of \$10,000, and the Comptroller of the Currency, as ex officio member of said Federal Reserve Board, shall, in addition to the salary now paid him as comptroller, receive the sum of \$5,000 annually for his services as a member of said board. Of those thus appointed by the President at least one shall be a person experienced in banking, and of those first appointed, one shall serve for two, one for four, one for six, and one for eight years, respectively, and thereafter each member so appointed shall serve for a term of eight years. Of the four persons thus appointed, one of such members is to be designated as governor, one as vice governor, and one as secretary of the Federal Reserve Board. The governor of the Federal Reserve Board, subject to the supervision of the Secretary of the Treasury and board, shall be the active managing officer of the Federal Reserve Board. He shall be subject to removal by the President upon a statement of the reasons for such removal.

The Federal Reserve Board shall have power to levy semiannually upon the Federal reserve banks, in proportion to capital, an assessment sufficient to pay its estimated expenses for the half year succeeding the levying of such assessment, together with any deficit carried forward from the preceding half year.

That the first meeting of the Federal Reserve Board shall be held in Washington, District of Columbia, as soon as may be after the passage of this Act, and after the organization of Federal reserve banks in the several districts, as herein provided, at a date to be fixed by the reserve organization committee hereinbefore created. The Secretary of the Treasury shall be ex officio chairman of the Federal Reserve Board. No member of the Federal

Reserve Board shall continue to hold office or to act as a director of any bank or banking institution or Federal reserve bank, and before entering upon his duties as a member of the Federal Reserve Board he shall certify under oath to the Secretary of the Treasury that he has complied with this requirement. Whenever a vacancy shall occur among the four members of the Federal Reserve Board chosen by the President, as above provided, a successor shall be appointed by the President, with the advice and consent of the Senate, to fill such vacancy, and when chosen, shall hold office for the unexpired term of the member whose place he is selected to fill.

That section three hundred and twenty-four of the Revised Statutes of the United States be amended so as to read as follows: "There shall be in the Department of the Treasury a bureau charged, except as in this Act otherwise provided, with the execution of all laws passed by Congress relating to the issue and regulation of currency issued by national banking associations, the chief officer of which bureau shall be called the Comptroller of the Currency, and shall perform his duties under the general direction of the Secretary of the Treasury, acting as the chairman of the Federal Reserve Board."

SEC 12 That the Federal Reserve Board hereinbefore established shall be authorized and empowered

(a) To examine at its discretion the accounts and books of each Federal reserve bank and to require such statements and reports as it deems necessary

(b) To require or on application to permit a Federal reserve bank to rediscount the paper of any other Federal reserve bank

(c) To establish each week, or as much oftener as required, a rate of discount which shall be mandatory upon each Federal reserve bank and for each class of paper. *Provided*, That said rate of discount need not be uniform for all Federal reserve banks, but shall be made with a view to accommodating the commerce of the country and promoting a stable price level

(d) To suspend for a period not exceeding thirty days (and to renew such suspension for periods not to exceed fifteen days) any and every reserve requirement specified in this Act

(e) To supervise and regulate the issue of Treasury notes to Federal reserve banks

(f) To add to the number of cities classified as reserve and central reserve cities under existing law in which national banking associations are subject to the reserve requirements set forth in section twenty-one of this Act, or to reclassify existing reserve and central reserve cities and to designate the banks therein situated as country banks at its discretion

(g) To require the removal of officials of Federal reserve banks for incompetency, dereliction of duty, fraud, or deceit

(h) To require the writing off of doubtful or worthless assets upon the books and balance sheets of Federal reserve banks

(i) To suspend the further operations of any Federal reserve bank and appoint a receiver therefor

(j) To perform the duties, functions, or services specified or implied in this Act

REDISCOUNTS

SEC 13 That any Federal reserve bank may receive from any of its stockholders deposits of current funds in lawful money, national-bank notes, Federal reserve notes or checks and drafts upon solvent banks, domestic and foreign

Upon the indorsement of any member bank any Federal reserve bank may discount notes and bills of exchange arising out of commercial transactions, that is, notes and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, the Federal Reserve Board to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this Act, but such definition shall not include notes or bills issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities, except notes or bills having a maturity of not exceeding four months and secured by United States bonds or bonds issued by any State, county, or municipality of the United States. Notes and bills admitted to discount under the terms of this paragraph must have a maturity of not more than forty-five days

Upon the indorsement of any member bank any Federal reserve bank may discount the paper of the classes hereinbefore described having a maturity of more than forty-five and not more than one hundred and twenty days, when its own cash reserve exceeds thirty-three and one-third per cent of its total outstanding demand liabilities, but not more than fifty per cent of the total paper so discounted for any depositing bank shall have a maturity of more than sixty days

Upon the indorsement of any bank having a deposit with it any Federal reserve bank may discount acceptances of depositing banks which are based on the exportation or importation of goods or on travelers' credits and which mature in not more than ninety days and bear the signature of at least one member bank in addition to that of the acceptor. The amount so discounted shall at no time exceed one-half the capital of the bank for which the rediscounts are made. The aggregate of such notes and bills bearing the signature or indorsement of any one person, company, firm, or corporation rediscounted for any one bank shall at no time exceed ten per centum of the unimpaired capital and surplus of said bank

Any national bank may, at its discretion, accept drafts or bills of exchange drawn upon it having not more than four months to run and growing out of the transactions involving the importation or exportation

of goods or the issue of travelers' letters of credit, but no bank shall accept such bills to an amount equal in the aggregate to more than one-half the face value of its paid-up and unimpaired capital

SEC 14 Whenever in the opinion of the Federal Reserve Board, upon application jointly and directly made to the Secretary of the Treasury by not less than ten national banks in one district, the public interest so requires, the Federal Reserve Board may authorize the reserve bank of the district to discount the direct obligations of member banks, secured by the pledge and deposit of satisfactory securities, but in no case shall the amount so loaned by a Federal reserve bank exceed three-fourths of the actual value of the securities so pledged or one-half the amount of the paid-up and unimpaired capital of the member bank

OPEN-MARKET OPERATIONS

SEC 15 That any Federal reserve bank may, under rules and regulations prescribed by the Federal Reserve Board, purchase in the open market, either from domestic or foreign banks or individuals, bankers' bills and bills of exchange of the kinds and maturities by this Act made eligible for rediscount

Every Federal reserve bank shall have power (a) to deal in gold coin and bullion both at home and abroad, to make loans thereon, and to contract for loans of gold coin or bullion, giving therefor, when necessary, acceptable security, including the hypothecation of United States bonds, (b) to invest in United States bonds and in short-time obligations of the United States or its dependencies or of any State or foreign Government, (c) to purchase from member banks and to sell, with or without its indorsement, checks or bills of exchange arising out of commercial transactions, as hereinbefore defined, payable in foreign countries, but such bills of exchange must have not exceeding ninety days to run and must bear the signature of two or more responsible parties, of which the last shall be that of a subscribing bank, and (d) with the consent of the Federal Reserve Board, to open and maintain banking accounts in foreign countries and establish agencies in such countries wheresoever it may deem best for the purpose of purchasing, selling, and collecting foreign bills of exchange, and to buy and sell with or without its indorsement, through such correspondents or agencies, checks or prime foreign bills of exchange arising out of commercial transactions which have not exceeding ninety days to run and which bear the signature of two or more responsible parties

GOVERNMENT DEPOSITS

SEC 16 That all moneys now held in the general fund of the Treasury shall, upon the direction of the Secretary of the Treasury, within twelve months of the passage of this Act, be deposited in Federal reserve banks, which shall act as fiscal agents of the United States, and thereafter the

revenues of the Government shall be regularly deposited in such banks, and disbursements shall be made by checks drawn against such deposits

The Secretary of the Treasury shall, from time to time, apportion the funds of the Government among the said Federal reserve banks, and may, at his discretion, charge interest thereon and fix, from month to month, a rate which shall be regularly paid by the banks holding such deposit *Provided*, That no Federal reserve bank shall pay interest upon any deposits except those of the United States

The Government of the United States and the banks depositing in the Federal reserve banks shall be the only depositors in said reserve banks All domestic transactions of the Federal reserve banks involving the creation of deposit accounts shall be confined to the Government and the depositing banks, with the exception of the purchase or sale of Government or State securities, or securities of foreign Governments, or of gold coin or bullion

NOTE ISSUES

SEC 17 That an issue of Federal reserve Treasury notes not to exceed \$500,000,000 is hereby authorized The said notes shall purport on their faces to be the obligations of the United States, and shall be issued, at the discretion of the Federal Reserve Board, and solely for the purpose of making advances to Federal reserve banks, as hereinafter set forth They shall be receivable for all taxes, customs, and other public dues, and shall be redeemed in gold on demand at the Treasury Department in the city of Washington, District of Columbia, or at any Federal reserve bank, and when deposited with such bank for redemption may be charged off by said bank against Treasury balances on its books, or may be paid out of its lawful money funds specifically set apart for their redemption

Any Federal reserve bank may, upon vote of its directors, make application to the Federal Reserve Board through the local Federal reserve agent for such amount of the Treasury notes hereinbefore provided for as it may deem best Such application shall be accompanied with a tender to the local reserve agent of collateral security to protect the notes for which application is made, equal in amount to the sum of the notes thus applied for The collateral security thus offered shall be notes and bills accepted for rediscount under the provisions of section thirteen of this Act, and the Federal Reserve Board shall be authorized at any time to call upon a Federal reserve bank for additional deposits of security

Whenever any Federal reserve bank shall pay out or disburse Federal reserve Treasury notes of the issue herein provided it shall hold in its own vaults gold or lawful money equal in amount to thirty-three and one-third per centum of the Treasury notes so paid out by it The Federal Reserve Board shall have power, in its discretion to require Federal reserve banks to maintain on deposit in the Treasury of the United States a sum in gold or lawful money equal to five per centum of whatever amount of Federal

reserve Treasury notes may be issued to them under the provisions of this Act, but such five per centum shall be counted and included as part of the thirty-three and one-third per centum reserve hereinbefore required. It shall also have the right to grant in whole or in part or to reject entirely the application of any Federal reserve bank for Federal reserve Treasury notes, but to the extent and in the amount that such application may be granted the Federal Reserve Board shall, through its local Federal agent, deposit Treasury notes with the bank so applying, and such bank shall be charged with the amount of such notes and shall pay such rate of interest on said amount as may be established by the Federal Reserve Board, and the amount of such Treasury notes so issued to any such bank shall, upon delivery, become a first and paramount lien on all the assets of such bank.

Any Federal reserve bank may at any time reduce its liability for outstanding Federal reserve Treasury notes by the deposit of Federal reserve Treasury notes whether issued to such bank or to some other member bank, other lawful money of the United States, or gold bullion, with the Treasurer of the United States, and such reduction shall be accompanied by a corresponding reduction in the reserve fund of lawful money set apart for the redemption of said notes and by the release of a corresponding amount of the collateral security deposited with the local Federal reserve agent.

Any Federal reserve bank may at its discretion withdraw collateral deposited with the local Federal reserve agent for the protection of Federal reserve Treasury notes deposited with it and shall at the same time substitute other collateral of equal value approved by the Federal reserve agent under regulations to be prescribed by the Federal Reserve Board.

It shall be the duty of every Federal reserve bank to receive on deposit, at par and without charge for exchange or collection, checks and drafts drawn by any of its depositors upon any other depositor and checks and drafts drawn by any depositor in any other Federal reserve bank upon funds to the credit of said depositor in said reserve bank last mentioned. The Federal Reserve Board shall make and promulgate from time to time regulations governing the transfer of funds at par among Federal reserve banks, and may at its discretion exercise the functions of a clearing house for such Federal reserve banks, and may also require each such bank to exercise the functions of a clearing house for its shareholding banks.

Any Federal reserve bank may at its discretion withdraw collateral deposited with the local Federal reserve agent for the protection of Federal reserve Treasury notes deposited with it and shall at the same time substitute other collateral of equal value approved by the Federal reserve agent under regulations to be prescribed by the Federal Reserve Board.

BANK RESERVES

Sec 18 That within sixty days from and after the date when the Secretary of the Treasury shall have officially announced, in such manner as he

shall elect, the fact that a Federal reserve bank has been established, every national banking association shall establish with the Federal reserve bank of its district a credit balance on the books of the latter institution equal to not less than three per centum of its own total demand liabilities, exclusive of circulating notes, and at the end of fourteen months from the date fixed by the Secretary of the Treasury shall increase the said three per centum to five per centum. Such balance may at any time be increased, but shall at no time be allowed to fall below the amounts aforesaid.

From and after the date set by the Secretary of the Treasury and officially announced by him as hereinbefore provided, it shall be the duty of national banking associations now classified as country banks and situated outside of central reserve and reserve cities to maintain a reserve equal to fifteen per centum of the aggregate amount of their deposits. Such reserve shall consist of five per centum of lawful money held actually in their own vaults and for a period of fourteen months from the date aforesaid shall consist of at least three per centum and thereafter of at least five per centum, with its district Federal reserve bank. The remainder of the fifteen per centum reserve hereinbefore required may for a period of thirty-six months from and after the date set by the Secretary of the Treasury, as hereinbefore provided, consist of balances due to a national bank in reserve or central reserve cities as now defined by law. From and after a date thirty-six months subsequent to the date set by the Secretary of the Treasury, as hereinbefore provided, the said remainder of the fifteen per centum reserve required of country banks shall consist either of lawful money in its own vaults or of balances on deposit with the Federal reserve bank of its district, or both.

BANKS IN RESERVE CITIES

From and after the date set by the Secretary of the Treasury for the incorporation of the Federal reserve bank within such district it shall be the duty of the national banks in such reserve cities to maintain for a period of twenty-six months a reserve of twenty-five per centum of their outstanding deposits and for twelve months thereafter a reserve of twenty-two and one-half per centum, and at the end of thirty-eight months, and permanently thereafter, a reserve of twenty per centum of their outstanding deposits. For sixty days from the date set by the Secretary for the organization of the reserve bank in such district each national bank in the reserve cities shall maintain in its own vaults, in lawful money, a sum equal to twelve and one-half per centum of its outstanding deposits and thereafter a sum of lawful money equal to ten per centum of its deposits. The additional legal reserve above the lawful money required in its own vaults may be kept either with the Federal reserve bank or with a reserve agent in the central reserve cities, for a period not exceeding thirty-six months from the organization of the Federal reserve bank in such district.

Provided, however, That the requirement of a balance of three per centum and five per centum, respectively, of its deposits with the Federal reserve bank of its district, as hereinbefore provided, shall not be diminished

CENTRAL RESERVE CITY BANKS

The national banks in central reserve cities, for a period of fourteen months, shall maintain a reserve, in lawful money, equal to twenty-five per centum of their deposits and thereafter, for a further period of twelve months, a reserve in lawful money equal to twenty-two and one-half per centum of their deposits and after twenty-six months they shall maintain a reserve in lawful money equal to twenty per centum of their outstanding deposits. For a period of sixty days after the passage of this Act each such bank shall maintain, in its own vaults, in lawful money, a sum equal to twenty per centum of its deposits, and thereafter, in lawful money, ten per centum of its deposits. It shall be optional with such banks to keep their reserve, in addition to the lawful money required to be kept by them as aforesaid, either in their own vaults or as a deposit with the Federal reserve bank of the district in which such national bank is located. *Provided, however,* That the requirement of a balance of three per centum and five per centum respectively, with the Federal reserve bank of its district, as hereinbefore provided, shall not be diminished

SEC 19 That so much of sections two and three of the Act of June twentieth, eighteen hundred and seventy-four, entitled "An Act fixing the amount of United States notes, providing for a redistribution of the national bank currency, and for other purposes," as provides that the fund deposited by any national banking association with the Treasurer of the United States for the redemption of its notes shall be counted as a part of its lawful reserve as provided in the Act aforesaid, be, and the same is hereby, repealed. And from and after the passage of this Act such fund of five per centum shall in no case be counted by any national banking association as a part of its lawful reserve

SEC 20 That every Federal reserve bank shall at all times have on hand in its own vaults, in gold or lawful money, a sum equal to not less than thirty-three and one-third per centum of its outstanding demand liabilities, which shall at the same time be not less than thirty-three and one-third per centum of its outstanding Federal reserve notes

BANK EXAMINATIONS

SEC 21 That the examination of the affairs of every national banking association authorized by existing law shall take place at least twice in each calendar year and as much oftener as the Federal Reserve Board shall consider necessary in order to furnish a full and complete knowledge of its condition. The Secretary of the Treasury may, however, at any time direct the holding of a special examination. The person assigned to the

making of such examination of the affairs of any national banking association shall have power to call together a quorum of the directors of such association, who shall, under oath, state to such examiner the character and circumstances of such of its loans or discounts as he may designate, and from and after the passage of this Act all bank examiners shall receive fixed salaries, the amount whereof shall be determined by the Federal Reserve Board and shall be annually reported to Congress. But the expense of the examinations herein provided for shall be assessed by the Federal Reserve Board upon the associations examined in proportion to assets or resources held by such associations upon a date during the year in which such examinations are held to be established by the Federal Reserve Board. The Comptroller of the Currency shall so arrange the duties of national bank examiners that no two successive examinations of any association shall be made by the same examiner.

In addition to the examinations made and conducted by the Comptroller of the Currency, every Federal reserve bank may, with the approval of the Federal Reserve Board, arrange for special or periodical examination of the member banks within its district. Such examination shall be so conducted as to inform the Federal reserve bank under whose auspices it is carried on of the condition of its member banks and of the lines of credit which are being extended by them. Every Federal reserve bank shall at all times be bound to furnish to the Federal Reserve Board such information as may be demanded by the latter concerning the condition of any national banking association organized within the district in which the said Federal reserve bank is located, and it shall have power at all times to order special examinations without notice, for the purpose of ascertaining the condition of a member bank.

The Federal Reserve Board shall as often as it deems best, and in any case not less frequently than four times each year, order an examination of national banking associations in reserve cities. Such examinations shall show in detail the total amount of loans made by each bank on demand, on time, and the different classes of collateral held to protect the various loans.

SEC 22 That no national bank shall hereafter make any loan or grant any gratuity to any examiner of such bank. Any bank offending against this provision shall be deemed guilty of a misdemeanor and shall be fined not more than \$1,000, and a further sum equal to the money so loaned or gratuity given, and the officer or officers of a bank making such loan or granting such gratuity shall be likewise deemed guilty of a misdemeanor and shall be fined not to exceed \$500. Any examiner accepting a loan or gratuity from any bank examined by him shall be deemed guilty of a misdemeanor and shall be fined not more than \$500, and a further sum equal to the money so loaned or gratuity given, and shall forever thereafter be disqualified from holding office as a national-bank examiner. No national-

bank examiner shall perform any other service for compensation while holding such office

No officer or director of a national bank shall receive or be beneficiary, either directly or indirectly, of any fee, brokerage, commission, gift, or other consideration for or on account of any loan, purchase, sale, payment, exchange, or transaction made by or on behalf of a national bank of which he is such officer or director. Any person violating any provision of this Act shall be punished by a fine of not exceeding \$5,000, or by a term in the penitentiary not exceeding three years, or both such fine and imprisonment

SEC 23 That from and after the passage of this Act the stockholders of every national banking association shall be held individually responsible for all contracts, debts, and engagements of such association, each to the amount of his stock therein, at the par value thereof in addition to the amount invested in such stock. The stockholders in any national banking association who shall have transferred their shares or registered the transfer thereof within sixty days next before the date of the failure of such association to meet its obligations shall be liable to the same extent as if they had made no such transfer, but this provision shall not be construed to affect in any way any recourse which such shareholders might otherwise have against those in whose names such shares are registered at the time of such failure. Section fifty-one hundred and fifty-one, Revised Statutes of the United States, is hereby reenacted except in so far as modified by this section

LOANS ON FARM LANDS

SEC 24 That any national banking association not situated in a reserve city or central reserve city may make loans secured by improved and unencumbered farm land, and so much of section fifty-one hundred and thirty-seven of the Revised Statutes as prohibits the making of such loans by banks so situated shall be, and the same is hereby, repealed, but no such loan shall be made for a longer time than nine months, nor for an amount exceeding fifty per centum of the actual value of the property offered as security, and such property shall be situated within the Federal reserve district in which the bank is located. Any such bank may make such loans in an aggregate sum equal to twenty-five per centum of its capital and surplus, or fifty per centum of its time deposits

The Federal Reserve Board shall have power from time to time to add to the list of cities in which national banks shall not be permitted to make loans secured upon real estate in the manner described in this section

FOREIGN BRANCHES

SEC 25 That any national banking association possessing a capital of \$1,000,000 or more may file application with the Federal Reserve Board,

upon such conditions and under such circumstances as may be prescribed by the said board, for the purpose of securing authorization to establish branches in foreign countries for the furtherance of the foreign commerce of the United States and to act, if required to do so, as fiscal agents of the United States. Such application shall specify, in addition to the name and capital of the banking association filing it, the foreign country or countries or the dependencies of the United States where the banking operations proposed are to be carried on and the amount of capital set aside by the said banking association filing application for the conduct of its foreign business at the branches proposed by it to be established in foreign countries. The Federal Reserve Board shall have power to reject such application if, in its judgment, the amount of capital proposed to be set aside for the conduct of foreign business is inadequate or if for other reasons the granting of such application is deemed inexpedient.

Every national banking association which shall receive authorization to establish branches in foreign countries shall be required at all times to furnish information concerning the condition of such branches to the Comptroller of the Currency upon demand, and the Federal Reserve Board may order special examinations of the said foreign branches at such time or times as it may deem best. Every such national banking association shall conduct the accounts of each foreign branch independently of the accounts of other foreign branches established by it and of its home office, and shall at the end of each fiscal period transfer to its general ledger the profit or loss accruing at each such branch as a separate item.

SEC 26 That all provisions of law inconsistent with or superseded by any of the provisions of this Act, be, and the same are hereby, repealed

APPENDIX IV

GLASS BILL AS INTRODUCED IN THE HOUSE OF REPRESENTATIVES, JUNE 26, 1913

A BILL

To provide for the establishment of Federal reserve banks, for furnishing an elastic currency, affording means of rediscounting commercial paper, and to establish a more effective supervision of banking in the United States, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the short title of this Act shall be the "Federal Reserve Act"

FEDERAL RESERVE DISTRICTS

SEC 2 That within ninety days after the passage of this Act, or as soon thereafter as practicable, the Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency, acting as "The Reserve-Bank Organization Committee," shall designate from among the reserve cities now authorized by law a number of such cities to be known as Federal reserve cities, and shall divide the continental United States into districts, each district to contain one of such Federal reserve cities *Provided*, That the districts shall be apportioned with due regard to the convenience and customary course of business of the community and shall not necessarily coincide with the area of such State or States as may be wholly or in part included in any given district The districts thus created may be readjusted and new districts may from time to time be created by the Federal Reserve Board hereinafter established, acting upon a joint application made by not less than ten national banks situated within one of the existing districts The districts thus constituted shall be known as Federal reserve districts and shall be designated by number according to the pleasure of the organization committee

The organization committee shall, in accordance with regulations to be established by itself, proceed to organize in each of the reserve cities designated as hereinbefore specified a Federal reserve bank Each such Federal reserve bank shall include in its title the name of the city in which it is situated, as "Federal Reserve Bank of Chicago," and so forth The

total number of reserve cities designated by the organization committee shall be not less than twelve, and the organization committee shall be authorized to employ counsel and expert aid, to take testimony, to send for persons and papers, to administer oaths, and to make such investigations as may be deemed necessary by the said committee for the purpose of determining the number of reserve cities to be designated

Every national bank located within a given district shall be required to subscribe to the capital stock of the Federal reserve bank of that district a sum equal to twenty per centum of its unimpaired capital, one-half of such subscription to be paid in under the terms and conditions prescribed by the national banking Act with reference to subscriptions to the stock of national banking associations. The remainder of the subscriptions or any part thereof shall become a liability of the subscribers, subject to call and payment thereof whenever necessary to meet the obligations of the Federal reserve bank under such terms and in accordance with such regulations as the board of directors of said Federal reserve bank may prescribe. *Provided*, That no Federal reserve bank shall be organized with a paid-up and unimpaired capital at the time of beginning business less in amount than \$5,000,000. The organization committee shall have power to appoint such assistants and incur such expenses in carrying out the provisions of this Act as it shall deem necessary, and such expenses shall be payable by the Treasurer of the United States upon voucher approved by the Secretary of the Treasury, and the sum of \$100,000, or so much thereof as may be necessary, is hereby appropriated, out of any moneys in the Treasury not otherwise appropriated, for the payment of such expenses

STOCK ISSUES

SEC 3 That the capital stock of each Federal reserve bank shall be divided into shares of \$100. The outstanding capital stock shall be increased from time to time as subscribing banks increase their capital or as additional banks become subscribers, and shall be decreased as subscribing banks reduce their capital or leave the organization. Each Federal reserve bank may establish branch offices under regulations of the Federal Reserve Board at a point within the Federal reserve district in which it is located. *Provided*, That the total number of such branches shall not exceed one for each \$500,000 of the capital stock of said Federal reserve bank

FEDERAL RESERVE BANKS

SEC 4 That upon duly making and filing with the Comptroller of the Currency a certificate in the form required and described in sections fifty-one hundred and thirty-four and fifty-one hundred and thirty-five, Revised Statutes of the United States, such Federal reserve bank shall become a body corporate and as such and in the name designated, respectively, in the organization certificate shall have power to perform all those acts and to

enjoy all those privileges and to exercise all those powers described in section fifty-one hundred and thirty-six, Revised Statutes, save in so far as the same shall be limited or extended, as the case may be, by the provisions of this Act. The Federal reserve bank so incorporated shall have succession for a period of twenty years from its organization, unless sooner dissolved by Act of Congress.

Every Federal reserve bank shall be organized and conducted under the oversight and control of a board of directors, whose powers shall be the same as those conferred upon the boards of directors of national banking associations under existing law, except in so far as expressly provided to the contrary in this Act. Such board of directors shall be constituted and elected as hereinafter specified and shall consist of nine members, holding office for three years and divided into three classes, designated as classes A, B, and C.

Class A shall consist of three members, who shall be chosen by and be representative of the stock-holding banks.

Class B shall consist of three members, who shall be representative of the general public interests of the reserve district.

Class C shall consist of three members, who shall be designated by the Federal Reserve Board.

Directors of class A shall be chosen in the following manner:

It shall be the duty of the chairman of the board of directors of the Federal reserve bank of the district in which each such bank is situated to classify the member banks of the said district who are stockholders in the said Federal reserve bank into three general groups or divisions. Each such group shall contain as nearly as may be one-third of the aggregate number of the banks holding stock in the Federal reserve bank of the said district and shall consist of banks of similar capitalization. The said groups shall be designated by number at the pleasure of the chairman of the Federal reserve bank.

At a regularly called directors' meeting of each national bank in the Federal reserve district aforesaid, the board of directors of such member bank shall elect by ballot one of its own members as a district reserve elector and shall certify his name to the chairman of the board of directors of the Federal reserve bank of the district. The said chairman shall establish lists of the district reserve electors, class A, thus named by banks in each of the aforesaid three groups and shall transmit one list to each such elector in each group. Every elector shall, within fifteen days of the receipt of the said list, select and certify to the said chairman from among the names on the list pertaining to his group, transmitted to him by the chairman, one name, not his own, as representing his choice for Federal reserve director, class A. The name receiving the greatest number of votes, not less than a majority, shall be designated by said chairman as Federal reserve director for the group to which he belongs. In case no candidate

shall receive a majority of all votes cast in any district, the chairman aforesaid shall establish an eligible list, including the three names receiving the greatest number of votes on the first ballot, and shall transmit said list to the electors in each of the groups of banks established by him. Each elector shall at once select and certify to the said chairman from among the three names submitted to him his choice for Federal reserve director, class A, and the name receiving the greatest number of such votes shall be designated by the chairman as Federal reserve director, class A.

Directors of class B shall be chosen at the same time and in the same manner hereinbefore prescribed for directors of class A, except that they shall in no case be officers or directors of any bank or banking association, and shall not accept office as such during the term of their service as directors of the Federal reserve bank. They shall be fairly representative of the commercial, agricultural or industrial interests of their respective districts. The Federal Reserve Board shall have power at its discretion to remove any director of class B in any Federal reserve bank, if it should appear at any time that such director does not fairly represent the commercial, agricultural or industrial interests of his district.

Three directors belonging to class C shall be chosen directly by the Federal Reserve Board one of whom shall be designated by said board as chairman of the board of directors of the Federal reserve bank of the district to which he is appointed and shall be designated as "Federal reserve agent." In addition to his duties as chairman of the board of directors of the Federal reserve bank of the district to which he is appointed, he shall be required to maintain under regulations to be established by the Federal Reserve Board a local office of said board which shall be situated on the premises of the Federal reserve bank of the district. He shall make regular reports to the Federal Reserve Board, and shall act as its official representative for the performance of the functions conferred upon it by this Act. He shall be paid an annual compensation to be fixed by the Federal Reserve Board and to be paid him monthly by the Federal reserve bank to which he is designated.

The Reserve Bank Organization Committee may, in organizing Federal reserve banks for the first time, call such meetings of bank directors in the several districts as may be necessary to carry out the purpose of this Act and may exercise the functions herein conferred upon the chairman of the board of directors of each Federal reserve bank pending the complete organization of such bank.

At the first meeting of the full board of directors of each Federal reserve bank subsequent to the organization of such bank it shall be the duty of the directors of classes A and B and C each to designate one of its members whose term of office shall expire in one year from the first of January nearest to date of such meeting, one whose term of office shall

expire at the end of two years from said date, and one whose term of office shall expire at the end of three years from said date. Thereafter every director of a Federal reserve bank chosen as hereinbefore provided shall hold office for a term of three years but the chairman of the board of directors of each Federal reserve bank designated by the Federal Reserve Board, as hereinbefore described, shall be removable at the pleasure of the said board without notice, and his successor shall hold office during the unexpired term of the director in whose place he was appointed.

INCREASE AND DECREASE OF CAPITAL

SEC 5 That shares of the capital stock of Federal reserve banks shall not be transferable, nor be hypothecated, in case a subscribing bank increases its capital, it shall thereupon subscribe for an additional amount of capital stock of the Federal reserve bank of its district equal to twenty per centum of the bank's own increase of capital, paying therefor the then book value of the shares of the reserve bank as shown by the last published statement of said bank. A bank applying for stock in a Federal reserve bank at any time after the formation of the latter must subscribe for an amount of the capital of said reserve bank equal to twenty per centum of the capital of said subscribing bank, paying therefor its then book value as shown by the last published statement of said reserve bank. When the capital of any Federal reserve bank has been increased, either on account of the increase of capital of the banks holding stock therein or on account of the increase in the number of stockholding banks, the board of directors shall make and execute a certificate to the Comptroller of the Currency showing said increase in capital, the amount paid in, and by whom paid. In case a subscribing bank reduces its capital it shall surrender a proportionate amount of its holdings in the capital of said Federal reserve bank, and if a bank goes into voluntary liquidation it shall surrender all of its holdings of the capital of said Federal reserve bank. In either case the shares surrendered shall be canceled and the bank shall receive in payment therefor a sum equal to their then book value as shown by the last published statement of said Federal reserve bank.

SEC 6 That if any shareholder of a Federal reserve bank shall become insolvent and a receiver be appointed the stock held by it in said Federal reserve bank shall be canceled, and the balance of its value, after paying all debts due by such insolvent bank to said Federal reserve bank, shall be paid to the receiver of the insolvent bank. Whenever the capital stock of a Federal reserve bank is reduced, either on account of a reduction in capital of the banks holding its stock or of the liquidation or insolvency of any such bank holding stock therein, the board of directors shall make and execute a certificate to the Comptroller of the Currency showing such reduction of capital stock and the amount repaid to each bank.

DIVISION OF EARNINGS

SEC 7 That the earnings of each Federal reserve bank shall be disposed of in the following manner

After the payment of all expenses and taxes, the shareholders shall be entitled to receive an annual dividend of five per centum on the paid-in capital, which dividend shall be cumulative. One-half of the net earnings, after dividend claims, as hereinbefore provided, have been met, shall be paid into the surplus fund until said fund shall amount to twenty per centum of the paid-in capital of such bank, and the remaining one-half shall be paid to the United States, and whenever and so long as the surplus fund of such Federal reserve bank amounts to twenty per centum of the paid-in capital and the shareholders shall have received the dividends at the rate of five per centum per annum hereinbefore provided for, all excess earnings shall be paid to the United States

Every Federal reserve bank incorporated under the terms of this Act shall be exempt from Federal, State, and local taxation, except in respect to taxes upon real estate

SEC 8 That any national banking association heretofore organized may at any time within one year from the passage of this Act, and with the approval of the Comptroller of the Currency, be granted, as herein provided, all the rights, and be subject to all the liabilities, of national banking associations organized subsequent to the passage of this Act. *Provided*, That such action on the part of such associations shall be authorized by the consent in writing of shareholders owning not less than a majority of the capital stock of the association. Any national banking association now organized which shall not, within one year after the passage of this Act, become a national banking association under the provisions hereinbefore stated, or which shall fail to comply with any of the provisions of this Act, shall be dissolved, but such dissolution shall not take away or impair any remedy against such corporation, its stockholders or officers, for any liability or penalty which shall have previously been incurred

SEC 9. That any bank or banking association incorporated by special law of any State or of the United States, or organized under the general laws of any State of the United States, and having an unimpaired capital sufficient to entitle it to become a national banking association under the provisions of this Act, may, by the consent in writing of the shareholders owning not less than fifty-one per centum of the capital stock of such bank or banking association, and with the approval of the Comptroller of the Currency, become a national banking association under its former name or by any name approved by the comptroller. The directors thereof may continue to be the directors of the association so organized until others are elected or appointed in accordance with the provisions of the law. When the comptroller has given to such bank or banking association a certificate that the provisions of this Act have been complied with, such bank or bank-

ing association, and all its stockholders, officers, and employees, shall have the same powers and privileges, and shall be subject to the same duties, liabilities, and regulations, in all respects, as shall have been prescribed for associations originally organized as national banking associations under this Act

STATE BANKS AS MEMBERS

SEC 10 That from and after the passage of this Act any bank or banking association or trust company incorporated by special law of any State, or organized under the general laws of any State or the United States, may make application to the Federal Reserve Board hereinafter created for the right to subscribe to the stock of the Federal reserve bank organized within the Federal reserve district where located The Federal Reserve Board may, at its discretion, subject to the provisions of this section, entitle such applying bank to become a stockholder in the Federal reserve bank of the district in which such applying bank is located, or at its discretion may reject such application or cancel the membership of a bank Whenever the Federal Reserve Board may entitle such an applying bank to become a stockholder in the Federal reserve bank of the district in which the applying bank is located, stock shall be issued and paid for under the rules and regulations in this Act provided for national banks which become stockholders in Federal reserve banks

It shall be the duty of the Federal Reserve Board to establish by-laws for the general government of its conduct in acting upon applications made by the State banks and banking associations and trust companies heretofore referred to for stock ownership in Federal reserve banks Such by-laws shall require of applying banks not organized under Federal law that they comply with the reserve requirements and submit to the inspection and regulation provided in this Act No such applying bank shall be admitted to stock ownership in a Federal reserve bank unless it possesses a paid-up unimpaired capital sufficient to entitle it to become a national banking association in the place where it is situated, under the provisions of the national banking Act, and conforms to the provisions herein prescribed for national banking associations of similar capitalization and to the regulations of the Federal Reserve Board

If at any time it shall appear to the Federal Reserve Board that a banking association or trust company organized under the laws of any State or of the United States has failed to comply with the provisions of this section or the regulations of the board, it shall be within the power of the said board to require such banking association or trust company to surrender its stock in the Federal reserve bank in which it holds shares upon receiving from such bank the then book value of the said shares in current funds, and said Federal reserve bank shall upon notice from the Federal Reserve Board be required to suspend the designated banking association

or trust company from further privileges of membership, and shall within thirty days of such notice cancel and retire its shares and make payment therefor in the manner herein provided .

FEDERAL RESERVE BOARD

SEC 11 That there shall be created a Federal Reserve Board, which shall consist of seven members, including the Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency, who shall be members ex officio, and four members chosen by the President of the United States, by and with the advice and consent of the Senate. The four members of the Federal Reserve Board chosen by the President and confirmed as aforesaid shall each receive an annual salary of \$10,000, and the Comptroller of the Currency, as ex officio member of said Federal Reserve Board, shall, in addition to the salary now paid him as comptroller, receive the sum of \$5,000 annually for his services as a member of said board. Of those thus appointed by the President at least one shall be a person experienced in banking, and one shall serve for two, one for four, one for six, and one for eight years, respectively, and thereafter each member so appointed shall serve for a term of eight years unless sooner removed for cause by the President. Of the four persons thus appointed, one shall be designated governor and one vice governor of the Federal Reserve Board. The governor of the Federal Reserve Board, subject to the supervision of the Secretary of the Treasury and board, shall be the active managing officer of the Federal Reserve Board.

The Federal Reserve Board shall have power to levy semiannually upon the Federal reserve banks, in proportion to capital, an assessment sufficient to pay its estimated expenses for the half year succeeding the levying of such assessment, together with any deficit carried forward from the preceding half year.

The first meeting of the Federal Reserve Board shall be held in Washington, District of Columbia, as soon as may be after the passage of this Act, and after the organization of Federal reserve banks in the several districts, as herein provided, at a date to be fixed by the Reserve Bank Organization Committee heretofore created. The Secretary of the Treasury shall be ex officio chairman of the Federal Reserve Board. No member of the Federal Reserve Board shall continue to hold office or to act as a director of any bank or banking institution or Federal reserve bank, and before entering upon his duties as a member of the Federal Reserve Board he shall certify under oath to the Secretary of the Treasury that he has complied with this requirement. Whenever a vacancy shall occur among the four members of the Federal Reserve Board chosen by the President, as above provided, a successor shall be appointed by the President, with the advice and consent of the Senate, to fill such vacancy, and when chosen,

shall hold office for the unexpired term of the member whose place he is selected to fill

Section three hundred and twenty-four of the Revised Statutes of the United States shall be amended so as to read as follows "There shall be in the Department of the Treasury a bureau charged, except as in this Act otherwise provided, with the execution of all laws passed by Congress relating to the issue and regulation of currency issued by national banking associations, the chief officer of which bureau shall be called the Comptroller of the Currency, and shall perform his duties under the general direction of the Secretary of the Treasury, acting as the chairman of the Federal Reserve Board"

SEC 12 That the Federal Reserve Board hereinbefore established shall be authorized and empowered

(a) To examine at its discretion the accounts, books, and affairs of each Federal reserve bank and to require such statements and reports as it may deem necessary

(b) To require or on application to permit a Federal reserve bank to rediscount the paper of any other Federal reserve bank

(c) To suspend for a period not exceeding thirty days (and to renew such suspension for periods not to exceed fifteen days) any and every reserve requirement specified in this Act

(d) To supervise and regulate the issue and retirement of Treasury notes to Federal reserve banks

(e) To add to the number of cities classified as reserve and central reserve cities under existing law in which national banking associations are subject to the reserve requirements set forth in section twenty-one of this Act, or to reclassify existing reserve and central reserve cities and to designate the banks therein situated as country banks at its discretion

(f) To require the removal of officials of Federal reserve banks for incompetency, dereliction of duty, fraud, or deceit

(g) To require the writing off of doubtful or worthless assets upon the books and balance sheets of Federal reserve banks

(h) To suspend the further operations of any Federal reserve bank and appoint a receiver therefor

(i) To perform the duties, functions, or services specified or implied in this Act

REDISCOUNTS

SEC 13 That any Federal reserve bank may receive from any of its stockholders deposits of current funds in lawful money, national-bank notes, Federal reserve notes, or checks and drafts upon solvent banks, domestic and foreign, or acceptances authorized by this Act

Upon the indorsement of any member bank any Federal reserve bank may discount notes and bills of exchange arising out of commercial trans-

actions, that is, notes and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, the Federal Reserve Board to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this Act, but such definition shall not include notes or bills issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities, except notes or bills having a maturity of not exceeding four months and secured by United States bonds or bonds issued by any State, county, or municipality of the United States. Notes and bills admitted to discount under the terms of this paragraph must have a maturity of not more than forty-five days.

Upon the indorsement of any member bank any Federal reserve bank may discount the paper of the classes hereinbefore described having a maturity of more than forty-five and not more than one hundred and twenty days, when its own cash reserve exceeds thirty-three and one-third per cent of its total outstanding demand liabilities, but not more than fifty per cent of the total paper so discounted for any depositing bank shall have a maturity of more than sixty days.

Upon the indorsement of any member bank any Federal reserve bank may discount acceptances of such banks which are based on the exportation or importation of goods and which mature in not more than ninety days and bear the signature of at least one member bank in addition to that of the acceptor. The amount so discounted shall at no time exceed one-half the capital of the bank for which the rediscounts are made. The aggregate of such notes and bills bearing the signature or indorsement of any one person, company, firm, or corporation rediscounted for any one bank shall at no time exceed ten per centum of the unimpaired capital and surplus of said bank.

Any member bank may, at its discretion, accept drafts or bills of exchange drawn upon it having not more than six months sight to run and growing out of transactions involving the importation or exportation of goods, but no bank shall accept such bills to an amount equal in the aggregate to more than one-half the face value of its paid-up and unimpaired capital.

SEC 14 Whenever in the opinion of the Federal Reserve Board the public interest so requires, the Federal Reserve Board may authorize the reserve bank of the district to discount the direct obligations of member banks, secured by the pledge and deposit of satisfactory securities, but in no case shall the amount so loaned by a Federal reserve bank exceed three-fourths of the actual value of the securities so pledged or one-half the amount of the paid-up and unimpaired capital of the member bank.

OPEN-MARKET OPERATIONS

SEC 15 That any Federal reserve bank may, under rules and regulations prescribed by the Federal Reserve Board, purchase and sell in the

open market, either from or to domestic or foreign banks or individuals, bankers' bills, cable transfers, and bills of exchange of the kinds and maturities by this Act made eligible for rediscount

Every Federal reserve bank shall have power (a) to deal in gold coin and bullion both at home and abroad, to make loans thereon, and to contract for loans of gold coin or bullion, giving therefor, when necessary, acceptable security, including the hypothecation of United States bonds, (b) to invest in United States bonds and in short-time obligations of the United States or its dependencies or of any State or foreign Government, (c) to purchase from member banks and to sell, with or without its indorsement, checks or bills of exchange arising out of commercial transactions, as heretofore defined, payable in foreign countries, but such bills of exchange must have not exceeding ninety days to run and must bear the signature of two or more responsible parties, of which the last shall be that of a subscribing bank, (d) to establish each week, or as much oftener as required, subject to review and determination of the Federal Reserve Board, a minimum rate of discount to be charged by such bank for each class of paper, which shall be made with a view to accommodating the commerce of the country and promoting a stable price level, and (e) with the consent of the Federal Reserve Board, to open and maintain banking accounts in foreign countries and establish agencies in such countries wheresoever it may deem best for the purpose of purchasing, selling, and collecting foreign bills of exchange, and to buy and sell with or without its indorsement, through such correspondents or agencies, checks or prime foreign bills of exchange arising out of commercial transactions which have not exceeding ninety days to run and which bear the signature of two or more responsible parties

GOVERNMENT DEPOSITS

SEC 16 That all moneys now held in the general fund of the Treasury shall, upon the direction of the Secretary of the Treasury, within twelve months of the passage of this Act, be deposited in Federal reserve banks, which shall act as fiscal agents of the United States, and thereafter the revenues of the Government shall be regularly deposited in such banks, and disbursements shall be made by checks drawn against such deposits

The Secretary of the Treasury shall, from time to time, apportion the funds of the Government among the said Federal reserve banks, and may, at his discretion, charge interest thereon and fix, from month to month, a rate which shall be regularly paid by the banks holding such deposits *Provided*, That no Federal reserve bank shall pay interest upon any deposits except those of the United States

The Government of the United States and the banks depositing in the Federal reserve banks shall be the only depositors in said reserve banks. All domestic transactions of the Federal reserve banks involving a redis-

count operation or the creation of deposit accounts shall be confined to the Government and the depositing banks, with the exception of the purchase or sale of Government or State securities, or securities of foreign Governments, or of gold coin or bullion

NOTE ISSUES

SEC 17 That an issue of Federal Reserve Treasury notes not to exceed \$500,000,000 and in addition thereto a sum equal to the difference between the total amount of national bank notes outstanding at any given moment and the amount of such notes outstanding at the passage of this Act is hereby authorized. The said notes shall purport on their faces to be the obligations of the United States, and shall be issued, at the discretion of the Federal Reserve Board, and solely for the purpose of making advances to Federal reserve banks,*as hereinafter set forth. They shall be receivable for all taxes, customs, and other public dues, and shall be redeemed in gold on demand at the Treasury Department in the city of Washington, District of Columbia, or at any Federal reserve bank, and when deposited with such bank for redemption may be charged off by said bank against Treasury balances on its books, or may be paid out of its lawful money funds specifically set apart for their redemption.

Any Federal reserve bank may, upon vote of its directors, make application to the Federal Reserve Board through the local Federal reserve agent for such amount of the Treasury notes hereinbefore provided for as it may deem best. Such application shall be accompanied with a tender to the local Federal reserve agent of collateral security to protect the notes for which application is made, equal in amount to the sum of the notes thus applied for. The collateral security thus offered shall be notes and bills accepted for rediscount under the provisions of sections thirteen, fourteen, and fifteen of this Act, and the Federal Reserve Board shall be authorized at any time to call upon a Federal reserve bank for additional deposits of security.

Whenever any Federal reserve bank shall pay out or disburse Federal reserve Treasury notes of the issue herein provided it shall segregate in its own vaults and shall carry to a special account on its books gold or lawful money equal in amount to thirty-three and one-third per centum of the Treasury notes so paid out by it. The Federal Reserve Board shall have power, in its discretion, to require Federal reserve banks to maintain on deposit in the Treasury of the United States a sum in gold or lawful money equal to five per centum of such amount of Federal Reserve Treasury notes as may be issued to them under the provisions of this Act, but such five per centum shall be counted and included as part of the thirty-three and one-third per centum reserve hereinbefore required. The said Board shall also have the right to grant in whole or in part or to reject entirely the application of any Federal Reserve bank for Federal Reserve

Treasury notes but to the extent and in the amount that such application may be granted the Federal Reserve Board shall, through its local Federal reserve agent, deposit Treasury notes with the bank so applying, and such bank shall be charged with the amount of such notes and shall pay such rate of interest on said amount as may be established by the Federal Reserve Board, and the amount of such Treasury notes so issued to any such bank shall, upon delivery, become a first and paramount lien on all the assets of such bank

Any Federal reserve bank may at any time reduce its liability for outstanding Federal reserve Treasury notes by the deposit of Federal reserve Treasury notes whether issued to such bank or to some other member bank, other lawful money of the United States, or gold bullion, with the Federal reserve agent or with the Treasurer of the United States, and such reduction shall be accompanied by a corresponding reduction in the reserve fund of lawful money set apart for the redemption of said notes and by the release of a corresponding amount of the collateral security deposited with the local Federal reserve agent

Any Federal reserve bank may at its discretion withdraw collateral deposited with the local Federal reserve agent for the protection of Federal reserve Treasury notes deposited with it and shall at the same time substitute other collateral of equal value approved by the Federal reserve agent under regulations to be prescribed by the Federal Reserve Board

It shall be the duty of every Federal reserve bank to receive on deposit, at par and without charge for exchange or collection, checks and drafts drawn upon any of its depositors or by any of its depositors upon any other depositor and checks and drafts drawn by any depositor in any other Federal reserve bank upon funds to the credit of said depositor in said reserve bank last mentioned. The Federal Reserve Board shall make and promulgate from time to time regulations governing the transfer of funds at par among Federal Reserve Banks, and may at its discretion exercise the functions of a clearing house for such Federal reserve banks, and may also require each such bank to exercise the functions of a clearing house for its shareholding banks

SEC 19 That so much of the provisions of section fifty-one hundred and fifty-nine of the Revised Statutes of the United States, and section four of the Act of June twentieth, eighteen hundred and seventy-four, and section eight of the Act of July twelfth, eighteen hundred and eighty-two, and of any other provisions of existing statutes, as require that before any national banking association shall be authorized to commence banking business it shall transfer and deliver to the Treasurer of the United States United States registered bonds to an amount, where the capital is \$150,000 or less, not less than one-fourth of its capital stock, and \$50,000 where the capital is in excess of \$150,000, be, and the same is hereby, repealed

REFUNDING BONDS

SEC 20 Upon application the Secretary of the Treasury shall exchange the two per centum bonds of the United States bearing the circulation privilege theretofore deposited by any national banking association with the Treasurer of the United States as security for circulating notes for three per centum bonds of the United States without the circulation privilege, payable after twenty years from date of issue, and exempt from Federal, State, and municipal taxation both as to income and principal. When and in proportion as the outstanding two per centum bonds deposited with the Treasurer shall be thus exchanged or refunded, the power of national banks to issue circulating notes secured by United States bonds shall cease and terminate. Every national bank may continue to apply for and receive from the Comptroller of the Currency circulating notes under the conditions provided by this Act, but no national bank shall be permitted to issue circulating notes of any description or to issue or to make use of any substitute for such circulating notes in the form of clearing-house certificates, cashier's checks, or other obligation not specifically provided for under this Act, and no national bank shall, without consent of the Secretary of the Treasury, in any one year present two per centum bonds for exchange in the manner hereinbefore provided to an amount exceeding five per centum of the total amount of bonds on deposit with the Treasurer by said bank at the time of the passage of this Act. At the expiration of twenty years from the passage of this Act every holder of United States two per centum bonds then outstanding shall receive payment therefor at par and accrued interest. After twenty years from the date of the passage of this Act national-bank notes still remaining outstanding shall be recalled and redeemed by the national banking associations issuing the same within a period and under regulations to be prescribed by the Federal Reserve Board, and notes still remaining in circulation at the end of such period shall be secured by an equal amount of lawful money deposited in the Treasury of the United States by the banking associations originally issuing such notes.

BANK RESERVES

SEC 21 That within sixty days from and after the date when the Secretary of the Treasury shall have officially announced, in such manner as he shall elect, the fact that a Federal reserve bank has been established, every national banking association shall establish with the Federal reserve bank of its district a credit balance on the books of the latter institution equal to not less than three per centum of its own total demand liabilities, exclusive of circulating notes, and at the end of fourteen months from the date fixed by the Secretary of the Treasury shall increase the said three per centum

to five per centum Such balance may at any time be increased, but shall at no time be allowed to fall below the amounts aforesaid

From and after the date set by the Secretary of the Treasury and officially announced by him as hereinbefore provided, it shall be the duty of national banking associations now classified as country banks and situated outside of central reserve and reserve cities to maintain a reserve equal to fifteen per centum of the aggregate amount of their deposits Such reserve shall consist of five per centum of lawful money held actually in their own vaults and for a period of fourteen months from the date aforesaid shall consist of at least three per centum and thereafter of at least five per centum, with its district Federal reserve bank The remainder of the fifteen per centum reserve hereinbefore required may for a period of thirty-six months from and after the date set by the Secretary of the Treasury, as hereinbefore provided, consist of balances due to a national bank in reserve or central reserve cities as now defined by law From and after a date thirty-six months subsequent to the date set by the Secretary of the Treasury, as hereinbefore provided, the said remainder of the fifteen per centum reserve required of country banks shall consist either of lawful money in its own vaults or of balances on deposit with the Federal reserve bank of its district, or both *Provided*, That the Federal Reserve Board may, in its discretion, permit said remainder of fifteen per centum reserve required of country banks to consist of balances on deposit with any bank in a reserve or central reserve city as defined by law

BANKS IN RESERVE CITIES

From and after the date set by the Secretary of the Treasury for the incorporation of the Federal reserve bank within such district it shall be the duty of the national banks in such reserve cities to maintain for a period of twenty-six months a reserve of twenty-five per centum of their outstanding deposits and for twelve months thereafter a reserve of twenty-two and one-half per centum, and at the end of thirty-eight months, and permanently thereafter, a reserve of twenty per centum of their outstanding deposits For sixty days from the date set by the Secretary for the organization of the reserve bank in such district each national bank in the reserve cities shall maintain in its own vaults, in lawful money, a sum equal to twelve and one-half per centum of its outstanding deposits and thereafter a sum of lawful money equal to ten per centum of its deposits The additional legal reserve above the lawful money required in its own vaults may be kept either with the Federal reserve bank or with a reserve agent in the central reserve cities, for a period not exceeding thirty-six months from the organization of the Federal reserve bank in such district *Provided, however*, That the requirement of a balance of three per centum and five per centum, respectively, of its deposits with the Federal reserve bank of its district, as hereinbefore provided, shall not be diminished,

CENTRAL RESERVE CITY BANKS

The national banks in central reserve cities, for a period of fourteen months, shall maintain a reserve, in lawful money, equal to twenty-five per centum of their deposits and thereafter, for a further period of twelve months, a reserve in lawful money equal to twenty-two and one-half per centum of their deposits and after twenty-six months they shall maintain a reserve in lawful money equal to twenty per centum of their outstanding deposits. For a period of sixty days after the passage of this Act each such bank shall maintain, in its own vaults, in lawful money, a sum equal to twenty per centum of its deposits, and thereafter, in lawful money, ten per centum of its deposits. It shall be optional with such banks to keep their reserve, in addition to the lawful money required to be kept by them as aforesaid, either in their own vaults or as a deposit with the Federal reserve bank of the district in which such national bank is located. *Provided, however,* That the requirement of a balance of three per centum and five per centum, respectively, with the Federal reserve bank of its district, as hereinbefore provided, shall not be diminished.

SEC 22 That so much of sections two and three of the Act of June twentieth, eighteen hundred and seventy-four, entitled "An Act fixing the amount of United States notes, providing for a redistribution of the national bank currency, and for other purposes," as provides that the fund deposited by any national banking association with the Treasurer of the United States for the redemption of its notes shall be counted as a part of its lawful reserve as provided in the Act aforesaid, be, and the same is hereby, repealed. And from and after the passage of this Act such fund of five per centum shall in no case be counted by any national banking association as a part of its lawful reserve.

SEC 23 That every Federal reserve bank shall at all times have on hand in its own vaults, in gold or lawful money, a sum equal to not less than thirty-three and one-third per centum of its outstanding demand liabilities.

BANK EXAMINATIONS

SEC 24 That the examination of the affairs of every national banking association authorized by existing law shall take place at least twice in each calendar year and as much oftener as the Federal Reserve Board shall consider necessary in order to furnish a full and complete knowledge of its condition. The Secretary of the Treasury may, however, at any time direct the holding of a special examination. The person assigned to the making of such examination of the affairs of any national banking association shall have power to call together a quorum of the directors of such association, who shall, under oath, state to such examiner the character and circumstances of such of its loans or discounts as he may designate, and from and after the passage of this Act all bank examiners shall receive fixed salaries,

the amount whereof shall be determined by the Federal Reserve Board and shall be annually reported to Congress. But the expense of the examinations herein provided for shall be assessed by the Federal Reserve Board upon the associations examined in proportion to assets or resources held by such associations upon a date during the year in which such examinations are held to be established by the Federal Reserve Board. The Comptroller of the Currency shall so arrange the duties of national bank examiners that no two successive examinations of any association shall be made by the same examiner.

In addition to the examinations made and conducted by the Comptroller of the Currency, every Federal reserve bank may, with the approval of the Federal Reserve Board, arrange for special or periodical examination of the member banks within its district. Such examination shall be so conducted as to inform the Federal reserve bank under whose auspices it is carried on of the condition of its member banks and of the lines of credit which are being extended by them. Every Federal reserve bank shall at all times be bound to furnish to the Federal Reserve Board such information as may be demanded by the latter concerning the condition of any national banking association organized within the district in which the said Federal reserve bank is located, and it shall have power at all times to order special examinations without notice, for the purpose of ascertaining the condition of a member bank.

The Federal Reserve Board shall as often as it deems best, and in any case not less frequently than four times each year, order an examination of national banking associations in reserve cities. Such examinations shall show in detail the total amount of loans made by each bank on demand, on time, and the different classes of collateral held to protect the various loans.

SEC 25 That no national bank shall hereafter make any loan or grant any gratuity to any examiner of such bank. Any bank offending against this provision shall be deemed guilty of a misdemeanor and shall be fined not more than \$1,000, and a further sum equal to the money so loaned or gratuity given, and the officer or officers of a bank making such loan or granting such gratuity shall be likewise deemed guilty of a misdemeanor and shall be fined not to exceed \$500. Any examiner accepting a loan or gratuity from any bank examined by him shall be deemed guilty of a misdemeanor and shall be fined not more than \$500, and a further sum equal to the money so loaned or gratuity given, and shall forever thereafter be disqualified from holding office as a national bank examiner. No national-bank examiner shall perform any other service for compensation while holding such office.

No officer or director of a national bank shall receive or be beneficiary, either directly or indirectly, of any fee, brokerage, commission, gift, or other consideration for or on account of any loan, purchase, sale, payment, exchange, or transaction made by or on behalf of a national bank of which

he is such officer or director. Any person violating any provision of this Act shall be punished by a fine of not exceeding \$5,000, or by a term in the penitentiary not exceeding three years, or both such fine and imprisonment.

SEC 26 That from and after the passage of this Act the stockholders of every national banking association shall be held individually responsible for all contracts, debts, and engagements of such association, each to the amount of his stock therein, at the par value thereof in addition to the amount invested in such stock. The stockholders in any national banking association who shall have transferred their shares or registered the transfer thereof within sixty days next before the date of the failure of such association to meet its obligations shall be liable to the same extent as if they had made no such transfer, but this provision shall not be construed to affect in any way any recourse which such shareholders might otherwise have against those in whose names such shares are registered at the time of such failure. Section fifty-one hundred and fifty-one, Revised Statutes of the United States, is hereby reenacted except in so far as modified by this section.

LOANS ON FARM LANDS

SEC 27 That any national banking association not situated in a reserve city or central reserve city may make loans secured by improved and unencumbered farm land, and so much of section fifty-one hundred and thirty-seven of the Revised Statutes as prohibits the making of such loans by banks so situated shall be, and the same is hereby, repealed, but no such loan shall be made for a longer time than nine months, nor for an amount exceeding fifty per centum of the actual value of the property offered as security, and such property shall be situated within the Federal reserve district in which the bank is located. Any such bank may make such loans in an aggregate sum equal to twenty-five per centum of its capital and surplus, or fifty per centum of its time deposits.

The Federal Reserve Board shall have power from time to time to add to the list of cities in which national banks shall not be permitted to make loans secured upon real estate in the manner described in this section.

FOREIGN BRANCHES

SEC 28 That any national banking association possessing a capital of \$1,000,000 or more may file application with the Federal Reserve Board, upon such conditions and under such circumstances as may be prescribed by the said board, for the purpose of securing authorization to establish branches in foreign countries for the furtherance of the foreign commerce of the United States and to act, if required to do so, as fiscal agents of the United States. Such application shall specify, in addition to the name and capital of the banking association filing it, the foreign country or countries or the dependencies of the United States where the banking operations pro-

posed are to be carried on and the amount of capital set aside by the said banking association filing application for the conduct of its foreign business at the branches proposed by it to be established in foreign countries. The Federal Reserve Board shall have power to reject such application if, in its judgment, the amount of capital proposed to be set aside for the conduct of foreign business is inadequate or if for other reasons the granting of such application is deemed inexpedient.

Every national banking association which shall receive authorization to establish branches in foreign countries shall be required at all times to furnish information concerning the condition of such branches to the Comptroller of the Currency upon demand, and the Federal Reserve Board may order special examinations of the said foreign branches at such time or times as it may deem best. Every such national banking association shall conduct the accounts of each foreign branch independently of the accounts of other foreign branches established by it and of its home office, and shall at the end of each fiscal period transfer to its general ledger the profit or loss accruing at each such branch as a separate item.

SEC 29 That all provisions of law inconsistent with or superseded by any of the provisions of this Act be, and the same are hereby, repealed

APPENDIX V

A GLASS BILL AS PASSED BY THE HOUSE

September 18, 1913

AN ACT

To provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the short title of this Act shall be the "Federal Reserve Act"

FEDERAL RESERVE DISTRICTS

SEC 2 That within ninety days after the passage of this Act, or as soon thereafter as practicable, the Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency, acting as "The Reserve Bank Organization Committee," shall designate from among the reserve and central reserve cities now authorized by law a number of such cities to be known as Federal reserve cities, and shall divide the continental United States into districts, each district to contain one of such Federal reserve cities *Provided*, That the districts shall be apportioned with due regard to the convenience and customary course of business of the community and shall not necessarily coincide with the area of such State or States as may be wholly or in part included in any given district The districts thus created may be readjusted and new districts may from time to time be created by the Federal Reserve Board hereinafter established, acting upon a joint application made by not less than ten member banks desiring to be organized into a new district The districts thus constituted shall be known as Federal reserve districts and shall be designated by number according to the pleasure of the organization committee, and no Federal reserve district shall be abolished, nor the location of a Federal reserve bank changed, except upon the application of three-fourths of the member banks of such district

The organization committee shall, in accordance with regulations to be established by itself, proceed to organize in each of the reserve cities designated as hereinbefore specified a Federal reserve bank Each such Federal reserve bank shall include in its title the name of the city in which it is

situated, as "Federal Reserve Bank of Chicago," and so forth. The total number of reserve cities designated by the organization committee shall be not less than twelve, and the organization committee shall be authorized to employ counsel and expert aid, to take testimony, to send for persons and papers, to administer oaths, and to make such investigations as may be deemed necessary by the said committee for the purpose of determining the reserve cities to be designated and organizing the reserve districts hereinbefore provided.

Every national bank located within a given district shall be required to subscribe to the capital stock of the Federal reserve bank of that district a sum equal to twenty per centum of the capital stock of such national bank fully paid in and unimpaired, one-fourth of such subscription to be paid in cash and one-fourth within sixty days after said subscription is made. The remainder of the subscription or any part thereof shall become a liability of the member bank, subject to call and payment thereof whenever necessary to meet the obligations of the Federal reserve bank under such terms and in accordance with such regulations as the board of directors of said Federal reserve bank may prescribe. *Provided*, That no Federal reserve bank shall commence business with a paid-up and unimpaired capital less in amount than \$5,000,000. The organization committee shall have power to appoint such assistants and incur such expenses in carrying out the provisions of this Act as it shall deem necessary, and such expenses shall be payable by the Treasurer of the United States upon voucher approved by the Secretary of the Treasury, and the sum of \$100,000, or so much thereof as may be necessary, is hereby appropriated, out of any moneys in the Treasury not otherwise appropriated, for the payment of such expenses.

STOCK ISSUES

SEC 3 That the capital stock of each Federal reserve bank shall be divided into shares of \$100 each. The outstanding capital stock shall be increased from time to time as member banks increase their capital stock or as additional banks become members, and shall be decreased as member banks reduce their capital stock or cease to be members. Each Federal reserve bank may establish branch offices under regulations of the Federal Reserve Board at points within the Federal reserve district in which it is located. *Provided*, That the total number of such branches shall not exceed one for each \$500,000 of the capital stock of said Federal reserve bank.

FEDERAL RESERVE BANKS

SEC 4 The national banks in each Federal reserve district uniting to form the Federal reserve bank therein, hereinbefore provided for, shall under their seals, make an organization certificate, which shall specifically state the name of such Federal reserve bank so organized, the territorial extent of the district over which the operations of said Federal reserve bank

are to be carried on, the city and State in which said bank is to be located, the amount of capital stock and the number of shares into which the same is divided, the names and places of doing business of each of the makers of said certificate and the number of shares held by each of them, and the fact that the certificate is made to enable such banks to avail themselves of the advantages of this Act. The said organization certificate shall be acknowledged before a judge of some court of record or notary public, and shall be, together with the acknowledgment thereof, authenticated by the seal of such court, or notary, transmitted to the Comptroller of the Currency, who shall file, record, and carefully preserve the same in his office. Upon the filing of such certificate with the Comptroller of the Currency as aforesaid, the said Federal reserve bank so formed shall become a body corporate, and as such, and in the name designated in such organization certificate, shall have power to perform all those acts and to enjoy all those privileges and to exercise all those powers described in section fifty-one hundred and thirty-six, Revised Statutes, save in so far as the same shall be limited by the provisions of this Act. The Federal reserve bank so incorporated shall have succession for a period of twenty years from its organization, unless sooner dissolved by Act of Congress.

Every Federal reserve bank shall be conducted under the oversight and control of a board of directors, whose powers shall be the same as those conferred upon the boards of directors of national banking associations under existing law, not inconsistent with the provisions of this Act. Such board of directors shall be constituted and elected as hereinafter specified and shall consist of nine members, holding office for three years, and divided into three classes, designated as classes A, B, and C.

Class A shall consist of three members, who shall be chosen by and be representative of the stock-holding banks.

Class B shall consist of three members, who shall be representative of the general public interests of the reserve district.

Class C shall consist of three members, who shall be designated by the Federal Reserve Board.

Directors of class A shall be chosen in the following manner:

It shall be the duty of the chairman of the board of directors of the Federal reserve bank of the district in which each such bank is situated to classify the member banks of the said district into three general groups or divisions. Each such group shall contain as nearly as may be one-third of the aggregate number of said member banks of the said district and shall consist, as nearly as may be, of banks of similar capitalization. The said groups shall be designated by number at the pleasure of the chairman of the board of directors of the Federal reserve bank.

At a regularly called directors' meeting of each member bank in the Federal reserve district aforesaid, the board of directors of such member bank shall elect by ballot one of its own members as a district reserve elector and shall certify his name to the chairman of the board of directors of the Fed-

eral reserve bank of the district The said chairman shall establish lists of the district reserve electors, class A, thus named by banks in each of the aforesaid three groups and shall transmit one list to each such elector in each group Every elector shall, within fifteen days of the receipt of the said list, select and certify to the said chairman from among the names on the list pertaining to his group, transmitted to him by the chairman, one name, not his own, as representing his choice for Federal reserve director, class A The name receiving the greatest number of votes, not less than a majority, shall be designated by said chairman as Federal reserve director for the group to which he belongs In case no candidate shall receive a majority of all votes cast in any group, the chairman aforesaid shall establish an eligible list, consisting of the three names receiving the greatest number of votes on the first ballot, and shall transmit said list to the electors in each of the groups of banks established by him Each elector shall at once select and certify to the said chairman from among the three persons submitted to him his choice for Federal reserve director, class A, and the name receiving the greatest number of such votes shall be declared by the chairman as Federal reserve director, class A In case of a tie vote the balloting shall continue in the manner hereinbefore prescribed until one candidate receives more votes than either of the others

Directors of class B shall be chosen by the electors of the respective groups at the same time and in the same manner prescribed for directors of class A, except that they must be selected from a list of names furnished, one by each member bank, and such names shall in no case be those of officers or directors of any bank or banking association They shall not accept office as such during the term of their service as directors of the Federal reserve bank They shall be fairly representative of the commercial, agricultural, or industrial interests of their respective districts The Federal Reserve Board shall have power at its discretion to remove any director of class B in any Federal reserve bank, if it should appear at any time that such director does not fairly represent the commercial, agricultural, or industrial interests of his district

Three directors belonging to class C shall be chosen directly by the Federal Reserve Board, and shall be residents of the district for which they are selected, one of whom shall be designated by said board as chairman of the board of directors of the Federal reserve bank of the district to which he is appointed and shall be designated as "Federal reserve agent" He shall be a person of tested banking experience, and in addition to his duties as chairman of the board of directors of the Federal reserve bank of the district to which he is appointed, he shall be required to maintain under regulations to be established by the Federal Reserve Board a local office of said board, which shall be situated on the premises of the Federal reserve bank of the district He shall make regular reports to the Federal Reserve Board, and shall act as its official representative for the performance of the functions conferred upon it by this Act He shall receive an annual com-

pensation to be fixed by the Federal Reserve Board and paid monthly by the Federal reserve bank to which he is designated

Directors of Federal reserve banks shall receive, in addition to any compensation otherwise provided, a reasonable allowance for necessary expenses in attending meetings of their respective boards, which amount shall be paid by the respective Federal reserve banks. Any compensation that may be provided by boards of directors of Federal reserve banks for members of such boards shall be subject to review by the Federal Reserve Board.

The Reserve Bank Organization Committee may, in organizing Federal reserve banks for the first time, call such meetings of bank directors in the several districts as may be necessary to carry out the purposes of this Act and may exercise the functions herein conferred upon the chairman of the board of directors of each Federal reserve bank pending the complete organization of such bank.

At the first meeting of the full board of directors of each Federal reserve bank after organization it shall be the duty of the directors of classes A and B and C, respectively, to designate one of the members of each class whose term of office shall expire in one year from the first of January nearest to date of such meeting, one whose term of office shall expire at the end of two years from said date, and one whose term of office shall expire at the end of three years from said date. Thereafter every director of a Federal reserve bank chosen as hereinbefore provided shall hold office for a term of three years, but the chairman of the board of directors of each Federal reserve bank designated by the Federal Reserve Board, as hereinbefore described, shall be removable at the pleasure of the said board without notice, and his successor shall hold office during the unexpired term of the director in whose place he was appointed. Vacancies that may occur in the several classes of directors of Federal reserve banks may be filled in the manner provided for the original selection of such directors, such appointees to hold office for the unexpired terms of their predecessors.

INCREASE AND DECREASE OF CAPITAL

Sec 5 That shares of the capital stock of Federal reserve banks shall not be transferable, nor be hypothecated. In case a member bank increases its capital, it shall thereupon subscribe for an additional amount of capital stock of the Federal reserve bank of its district equal to twenty per centum of the bank's own increase of capital, one-half of said subscription to be paid in cash in the manner hereinbefore provided for original subscription, and one-half to become a liability of the member bank according to the terms of the original subscription. A bank applying for stock in a Federal reserve bank at any time after the formation of the latter must subscribe for an amount of the capital of said Federal reserve bank equal to twenty per centum of the capital stock of said subscribing bank, paying therefor its par value in accordance with the terms prescribed by section two of this Act. When the capital stock of any Federal reserve bank has been in-

creased either on account of the increase of capital stock of member banks or on account of the increase in the number of member banks, the board of directors shall make and execute a certificate to the Comptroller of the Currency showing said increase in capital, the amount paid in, and by whom paid. In case a member bank reduces its capital stock it shall surrender a proportionate amount of its holdings in the capital of said Federal reserve bank, and in case a member bank goes into voluntary liquidation it shall surrender all of its holdings of the capital stock of said Federal reserve bank. In either case the shares surrendered shall be canceled and such member bank shall receive in payment therefor, under regulations to be prescribed by the Federal Reserve Board, a sum equal to its cash paid subscriptions on the shares surrendered.

SEC 6 That if any member bank shall become insolvent and a receiver be appointed, the stock held by it in said Federal reserve bank shall be canceled and the balance, after deducting from the amount of its cash paid subscriptions all debts due by such insolvent bank to said Federal reserve bank, shall be paid to the receiver of the insolvent bank. Whenever the capital stock of a Federal reserve bank is reduced, either on account of a reduction in capital stock of any member bank or of the liquidation or insolvency of any such member bank, the board of directors shall make and execute a certificate to the Comptroller of the Currency showing such reduction of capital stock and the amount repaid to such bank.

*DIVISION OF EARNINGS

SEC 7 That after the payment of all necessary expenses and taxes of a Federal reserve bank, the member banks shall be entitled to receive an annual dividend of five per centum on the paid-in capital stock, which dividend shall be cumulative. One-half of the net earnings, after the aforesaid dividend claims have been fully met, shall be paid into a surplus fund until such fund shall amount to twenty per centum of the paid-in capital stock of such bank, and of the remaining one-half sixty per centum shall be paid to the United States and forty per centum to the member banks in the ratio of their average balances with the Federal reserve bank for the preceding year. Whenever and so long as the surplus fund of a Federal reserve bank amounts to twenty per centum of the paid-in capital stock and the member banks shall have received the dividends at the rate of five per centum per annum hereinbefore provided for, sixty per centum of all excess earnings shall be paid to the United States and forty per centum to the member banks in proportion to their annual average balances with such Federal reserve bank, all earnings derived by the United States from Federal reserve banks shall constitute a sinking fund to be held for the reduction of the outstanding bonded indebtedness of the United States, said reduction to be accomplished under regulations to be prescribed by the Secretary of the Treasury. Should a Federal reserve bank be dissolved or go into liquidation, the surplus fund of said bank, after the payment of all debts and

dividend requirements as hereinbefore provided for, shall be paid to and become the property of the United States

Every Federal reserve bank incorporated under the terms of this Act and the capital stock therein held by member banks shall be exempt from Federal, State, and local taxation, except in respect to taxes upon real estate

SEC 8 That any national banking association heretofore organized may upon application at any time within one year after the passage of this Act, and with the approval of the Comptroller of the Currency, be granted, as herein provided, all the rights, and be subject to all the liabilities, of national banking associations organized subsequent to the passage of this Act *Provided*, That such application on the part of such associations shall be authorized by the consent in writing of stockholders owning not less than a majority of the capital stock of the association Any national banking association now organized which shall not, within one year after the passage of this Act, become a national banking association under the provisions hereinbefore stated, or which shall fail to comply with any of the provisions of this Act applicable thereto, shall be dissolved, but such dissolution shall not take away or impair any remedy against such corporation, its stockholders or officers, for any liability or penalty which shall have previously been incurred

SEC 9 That any bank or banking association incorporated by special law of any State or of the United States, or organized under the general laws of any State or the United States, and having an unimpaired capital sufficient to entitle it to become a national banking association under the provisions of existing laws, may, by the consent in writing of the shareholders owning not less than fifty-one per centum of the capital stock of such bank or banking association, and with the approval of the Comptroller of the Currency, become a national banking association under its former name or by any name approved by the comptroller The directors thereof may continue to be the directors of the association so organized until others are elected or appointed in accordance with the provisions of the law When the comptroller has given to such bank or banking association a certificate that the provisions of this Act have been complied with, such bank or banking association, and all its stockholders, officers, and employees, shall have the same powers and privileges, and shall be subject to the same duties, liabilities, and regulations in all respects, as shall have been prescribed by this Act or by the national banking Act for associations originally organized as national banking associations

STATE BANKS AS MEMBERS

SEC 10 That from and after the passage of this Act any bank or banking association or trust company incorporated by special law of any State, or organized under the general laws of any State or the United States, may make application to the Federal Reserve Board hereinafter created for the

right to subscribe to the stock of the Federal reserve bank organized or to be organized within the Federal reserve district where the applicant is located. The Federal Reserve Board, under such rules and regulations as it may prescribe, subject to the provisions of this section, shall permit such applying bank to become a stockholder in the Federal reserve bank of the district in which such applying bank is located. Whenever the Federal Reserve Board shall permit such applying bank to become a stockholder in the Federal reserve bank of the district in which the applying bank is located, stock shall be issued and paid for under the rules and regulations in this Act provided for national banks which become stockholders in Federal reserve banks.

It shall be the duty of the Federal Reserve Board to establish by-laws for the general government of its conduct in acting upon applications made by the State banks and banking associations and trust companies hereinbefore referred to for stock ownership in Federal reserve banks. Such by-laws shall require applying banks not organized under Federal law to comply with the reserve requirements and submit to the inspection and regulation provided for in this and other laws relating to national banks. No such applying bank shall be admitted to membership in a Federal reserve bank unless it possesses a paid-up unimpaired capital sufficient to entitle it to become a national banking association in the place where it is situated, under the provisions of the national banking Act, and conforms to the provisions herein prescribed for national banking associations of similar capitalization and to the regulations of the Federal Reserve Board.

If at any time it shall appear to the Federal Reserve Board that a banking association or trust company organized under the laws of any State or of the United States has failed to comply with the provisions of this section or the regulations of the Federal Reserve Board, it shall be within the power of the said board to require such banking association or trust company to surrender its stock in the Federal reserve bank in which it holds stock upon receiving from such Federal reserve bank the cash-paid subscriptions to the said stock in current funds, and said Federal reserve bank shall upon notice from the Federal Reserve Board be required to suspend said banking association or trust company from further privileges of membership, and shall within thirty days of such notice cancel and retire its stock and make payment therefor in the manner herein provided.

FEDERAL RESERVE BOARD

SEC 11 That there shall be created a Federal Reserve Board, which shall consist of seven members, including the Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency, who shall be members ex officio, and four members appointed by the President of the United States, by and with the advice and consent of the Senate. In selecting the four appointive members of the Federal Reserve Board, not more than one of whom shall be selected from any one Federal reserve district,

the President shall have due regard to a fair representation of different geographical divisions of the country. The four members of the Federal Reserve Board appointed by the President and confirmed as aforesaid shall devote their entire time to the business of the Federal Reserve Board and shall each receive an annual salary of \$10,000, together with an allowance for actual necessary traveling expenses, and the Comptroller of the Currency, as ex officio member of said Federal Reserve Board, shall, in addition to the salary now paid him as comptroller, receive the sum of \$5,000 annually for his services as a member of said board. Of the four members thus appointed by the President not more than two shall be of the same political party, and at least one of whom shall be a person experienced in banking. One shall be designated by the President to serve for two, one for four, one for six, and one for eight years, respectively, and thereafter each member so appointed shall serve for a term of eight years unless sooner removed for cause by the President. Of the four persons thus appointed, one shall be designated by the President as manager and one as vice manager of the Federal Reserve Board. The manager of the Federal Reserve Board, subject to the supervision of the Secretary of the Treasury and Federal Reserve Board, shall be the active executive officer of the Federal Reserve Board.

The Federal Reserve Board shall have power to levy semiannually upon the Federal reserve banks, in proportion to their capital stock, an assessment sufficient to pay its estimated expenses for the half year succeeding the levying of such assessment, together with any deficit carried forward from the preceding half year.

The first meeting of the Federal Reserve Board shall be held in Washington, District of Columbia, as soon as may be after the passage of this Act, at a date to be fixed by the Reserve Bank Organization Committee. The Secretary of the Treasury shall be ex officio chairman of the Federal Reserve Board. No member of the Federal Reserve Board shall be an officer or director of any bank or banking institution or Federal reserve bank nor hold stock in any bank or banking institution, and before entering upon his duties as a member of the Federal Reserve Board he shall certify under oath to the Secretary of the Treasury that he has complied with this requirement. Whenever a vacancy shall occur, other than by expiration of term, among the four members of the Federal Reserve Board appointed by the President, as above provided, a successor shall be appointed by the President, with the advice and consent of the Senate, to fill such vacancy, and when appointed shall hold office for the unexpired term of the member whose place he is selected to fill.

The Federal Reserve Board shall annually make a report of its fiscal operations to the Speaker of the House of Representatives, who shall cause the same to be printed for the information of the Congress.

Section three hundred and twenty-four of the Revised Statutes of the United States shall be amended so as to read as follows: "There shall be in the Department of the Treasury a bureau charged, except as in this Act

otherwise provided, with the execution of all laws passed by Congress relating to the issue and regulation of currency issued by or through banking associations, the chief officer of which bureau shall be called the Comptroller of the Currency, and shall perform his duties under the general direction of the Secretary of the Treasury, acting as the chairman of the Federal Reserve Board " *Provided, however,* That nothing herein contained shall be construed to affect any power now vested by law in the Comptroller of the Currency or the Secretary of the Treasury

SEC 12 That the Federal Reserve Board hereinbefore established shall be authorized and empowered

(a) To examine at its discretion the accounts, books, and affairs of each Federal reserve bank and to require such statements and reports as it may deem necessary The said board shall publish once each week a statement showing the condition of each Federal reserve bank and a consolidated statement for all Federal reserve banks Such statements shall show in detail the assets and liabilities of such Federal reserve banks, single and combined, and shall furnish full information regarding the character of the lawful money held as reserve and the amount, nature, and maturities of the paper owned by Federal reserve banks

(b) To permit or require, in time of emergency, Federal reserve banks to rediscount the discounted prime paper of other Federal reserve banks, at least five members of the Federal Reserve Board being present when such action is taken and all present consenting to the requirement The exercise of this compulsory rediscount power by the Federal Reserve Board shall be subject to an interest charge to the accommodated bank of not less than one nor greater than three per centum above the higher of the rates prevailing in the districts immediately affected

(c) To suspend for a period not exceeding thirty days (and to renew such suspension for periods not to exceed fifteen days) any and every reserve requirement specified in this Act *Provided,* That it shall establish a graduated tax upon the amounts by which the reserve requirements of this Act may be permitted to fall below the level hereinafter specified, such tax to be uniform in its application to all banks, but said board shall not suspend the reserve requirements with reference to Federal reserve notes

(d) To supervise and regulate the issue and retirement of Federal reserve notes and to prescribe the form and tenor of such notes

(e) To add to the number of cities classified as reserve and central reserve cities under existing law in which national banking associations are subject to the reserve requirements set forth in section twenty of this Act, or to reclassify existing reserve and central reserve cities and to designate the banks therein situated as country banks at its discretion

(f) To suspend the officials of Federal reserve banks and, for cause stated in writing with opportunity of hearing, require the removal of said officials for incompetency, dereliction of duty, fraud, or deceit, such removal to be subject to approval by the President of the United States

(g) To require the writing off of doubtful or worthless assets upon the books and balance sheets of Federal reserve banks

(h) To suspend, for cause relating to violation of any of the provisions of this Act, the operations of any Federal reserve bank and appoint a receiver therefor

(i) To perform the duties, functions, or services specified or implied in this Act

FEDERAL ADVISORY COUNCIL

SEC 13 There is hereby created a Federal Advisory Council, which shall consist of as many members as there are Federal reserve districts. Each Federal reserve bank by its board of directors shall annually select from its own Federal reserve district one member of said council, who shall receive no compensation for his services, but may be reimbursed for actual necessary expenses. The meetings of said advisory council shall be held at Washington, District of Columbia, at least four times each year, and oftener if called by the Federal Reserve Board. The council may select its own officers and adopt its own methods of procedure, and a majority of its members shall constitute a quorum for the transaction of business. Vacancies in the council shall be filled by the respective reserve banks, and members selected to fill vacancies shall serve for the unexpired term.

The Federal Advisory Council shall have power (1) to meet and confer directly with the Federal Reserve Board on general business conditions, (2) to make oral or written representations concerning matters within the jurisdiction of said board, (3) to call for complete information and to make recommendations in regard to discount rates, rediscount business, note issues, reserve conditions in the various districts, the purchase and sale of gold or securities by reserve banks, open-market operations by said banks, and the general affairs of the reserve banking system.

REDISCOUNTS

SEC 14 That any Federal reserve bank may receive from any member bank deposits of current funds in lawful money, national bank notes, Federal reserve notes, or checks and drafts upon solvent banks, payable upon presentation, or, solely for exchange purposes, may receive from other Federal reserve banks deposits of current funds in lawful money, national bank notes, or checks and drafts upon solvent banks, payable upon presentation.

Upon the indorsement of any member bank any Federal reserve bank may discount notes and bills of exchange arising out of commercial transactions, that is, notes and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes or the proceeds of which have been used, or may be used, for such purposes the Federal Reserve Board to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this Act, nothing herein contained shall be

construed to prohibit such notes and bills of exchange, secured by staple agricultural products, or other goods, wares, or merchandise from being eligible for such discount, but such definition shall not include notes or bills issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities. Notes and bills admitted to discount under the terms of this paragraph must have a maturity of not more than ninety days.

Upon the indorsement of any member bank any Federal reserve bank may discount the paper of the classes hereinbefore described having a maturity of more than ninety and not more than one hundred and twenty days, when its own cash reserve exceeds thirty-three and one-third per cent of its total outstanding demand liabilities exclusive of its outstanding Federal reserve notes by an amount to be fixed by the Federal Reserve Board, but not more than fifty per cent of the total paper so discounted for any member bank shall have a maturity of more than ninety days.

Upon the indorsement of any member bank any Federal reserve bank may discount acceptances of such banks which are based on the exportation or importation of goods and which mature in not more than six months and bear the signature of at least one member bank in addition to that of the acceptor. The amount so discounted shall at no time exceed one-half the capital stock of the bank for which the rediscounts are made.

The aggregate of such notes and bills bearing the signature or indorsement of any one person, company, firm, or corporation rediscounted for any one bank shall at no time exceed ten per centum of the unimpaired capital and surplus of said bank, but this restriction shall not apply to the discount of bills of exchange drawn in good faith against actually existing values.

Any national bank may, at its discretion, accept drafts or bills of exchange drawn upon it having not more than six months sight to run and growing out of transactions involving the importation or exportation of goods, but no bank shall accept such bills to an amount equal at any time to the aggregate to more than one-half the face value of its paid-up and unimpaired capital.

Section fifty-two hundred and two of the Revised Statutes of the United States is hereby amended so as to read as follows: No association shall at any time be indebted, or in any way liable, to an amount exceeding the amount of its capital stock at such time actually paid in and remaining unimpaired by losses or otherwise, except on account of demands of the nature following:

First Notes of circulation

Second Moneys deposited with or collected by the association

Third Bills of exchange or drafts drawn against money actually on deposit to the credit of the association, or due thereto

Fourth Liabilities to the stockholders of the association for dividends and reserve profits

Fifth Liabilities incurred under the provisions of sections two, five, and fourteen of the Federal reserve Act

OPEN-MARKET OPERATIONS

SEC 15 That any Federal reserve bank may, under rules and regulations prescribed by the Federal Reserve Board, purchase and sell in the open market, either from or to domestic or foreign banks, firms, corporations, or individuals, prime bankers' bills, and bills of exchange of the kinds and maturities by this Act made eligible for rediscount, and cable transfers

Every Federal reserve bank shall have power (a) to deal in gold coin and bullion both at home and abroad, to make loans thereon, and to contract for loans of gold coin or bullion, giving therefor, when necessary, acceptable security, including the hypothecation of United States bonds, (b) to invest in United States bonds, and bonds issued by any State, county, district, or municipality, (c) to purchase from member banks and to sell, with or without its indorsement, bills of exchange arising out of commercial transactions, as hereinbefore defined, payable in foreign countries, but such bills of exchange must have not exceeding ninety days to run and must bear the signature of two or more responsible parties, of which the last shall be that of a member bank, (d) to establish each week, or as much oftener as required, subject to review and determination of the Federal Reserve Board, a rate of discount to be charged by such bank for each class of paper, which shall be fixed with a view of accommodating the commerce of the country, and (e) with the consent of the Federal Reserve Board, to open and maintain banking accounts in foreign countries and establish agencies in such countries wheresoever it may deem best for the purpose of purchasing, selling, and collecting foreign bills of exchange, and to buy and sell with or without its indorsement, through such correspondents or agencies, prime foreign bills of exchange arising out of commercial transactions which have not exceeding ninety days to run and which bear the signature of two or more responsible parties

GOVERNMENT DEPOSITS

SEC 16 That all moneys now held in the general fund of the Treasury except the five per centum fund for the redemption of outstanding national-bank notes shall, upon the direction of the Secretary of the Treasury, within twelve months after the passage of this Act, be deposited in Federal reserve banks, which banks shall act as fiscal agents of the United States, and thereafter the revenues of the Government shall be regularly deposited in such banks, and disbursements shall be made by checks drawn against such deposits

The Secretary of the Treasury shall, subject to the approval of the Federal Reserve Board, from time to time, apportion the funds of the Government among the said Federal reserve banks, distributing them, as far as practicable, equitably between different sections, and may, at their joint

discretion, charge interest thereon and fix, from month to month, a rate which shall be regularly paid by the banks holding such deposits *Provided*, That no Federal reserve bank shall pay interest upon any deposits except those of the United States

No Federal reserve bank shall receive or credit deposits except from the Government of the United States, its own member banks, and, to the extent permitted by this Act, from other Federal reserve banks All domestic transactions of the Federal reserve banks involving loans made by such banks, rediscount operations or the creation of deposit accounts shall be confined to the Government and the depositing and Federal reserve banks, with the exception of the purchase or sale of Government or State securities or of gold coin or bullion

NOTE ISSUES

SEC 17 That Federal reserve notes, to be issued at the discretion of the Federal Reserve Board for the purpose of making advances to Federal reserve banks as hereinafter set forth and for no other purpose, are hereby authorized The said notes shall be obligations of the United States and shall be receivable for all taxes, customs, and other public dues They shall be redeemed in gold or lawful money on demand at the Treasury Department of the United States, in the city of Washington, District of Columbia, or at any Federal reserve bank

Any Federal reserve bank may, upon vote of its directors, make application to the local Federal reserve agent for such amount of the Federal reserve notes hereinbefore provided for as it may deem best Such application shall be accompanied with a tender to the local Federal reserve agent of collateral in amount equal to the sum of the Federal reserve notes thus applied for and issued pursuant to such application The collateral security thus offered shall be notes and bills accepted for rediscount under the provisions of section 14 of this Act, and the Federal reserve agent shall each day notify the Federal Reserve Board of issues and withdrawals of notes to and by the Federal reserve bank to which he is accredited The said Federal Reserve Board shall be authorized at any time to call upon a Federal reserve bank for additional security to protect the Federal reserve notes issued to it

Whenever any Federal reserve bank shall pay out or disburse Federal reserve notes issued to it as hereinbefore provided, it shall segregate in its own vaults and shall carry to a special reserve account on its books gold or lawful money equal in amount to thirty-three and one-third per centum of the reserve notes so paid out by it, such reserve to be used for the redemption of said reserve notes as presented, but any Federal reserve bank so using any part of such reserve to redeem notes shall immediately carry to said reserve account an amount of gold or lawful money sufficient to make said reserve equal to thirty-three and one-third per centum of its outstanding Federal reserve notes Notes so paid out shall bear upon their

faces a distinctive letter and serial number, which shall be assigned by the Federal Reserve Board to each Federal reserve bank. Whenever Federal reserve notes issued through one Federal reserve bank shall be received by another Federal reserve bank they shall be returned for redemption to the Federal reserve bank through which they were originally issued, or shall be charged off against Government deposits and returned to the Treasury of the United States, or shall be presented to the said Treasury for redemption. No Federal reserve bank shall pay out notes issued through another under penalty of a tax of ten per centum upon the face value of notes so paid out. Notes presented for redemption at the Treasury of the United States shall be paid and returned to the Federal reserve banks through which they were originally issued, and Federal reserve notes received by the Treasury otherwise than for redemption shall be exchanged for lawful money out of the five per centum redemption fund hereinafter provided and returned as heretofore provided to the reserve bank through which they were originally issued.

The Federal Reserve Board shall have power, in its discretion, to require Federal reserve banks to maintain on deposit in the Treasury of the United States a sum in gold equal to five per centum of such amount of Federal reserve notes as may be issued to them under the provisions of this Act, but such five per centum shall be counted and included as part of the thirty-three and one-third per centum reserve heretofore required. The said board shall also have the right to grant in whole or in part or to reject entirely the application of any Federal reserve bank for Federal reserve notes, but to the extent and in the amount that such application may be granted the Federal Reserve Board shall, through its local Federal reserve agent, deposit Federal reserve notes with the bank so applying, and such bank shall be charged with the amount of such notes and shall pay such rate of interest on said amount as may be established by the Federal Reserve Board, which rate shall not be less than one-half of one per centum per annum, and the amount of such Federal reserve notes so issued to any such bank shall, upon delivery, become a first and paramount lien on all the assets of such bank.

Any Federal reserve bank may at any time reduce its liability for outstanding Federal reserve notes by the deposit of Federal reserve notes, whether issued to such bank or to some other reserve bank, or lawful money of the United States, or gold bullion, with any Federal reserve agent or with the Treasurer of the United States, and such reduction shall be accompanied by a corresponding reduction in the required reserve fund of lawful money set apart for the redemption of said notes and by the release of a corresponding amount of the collateral security deposited with the local Federal reserve agent.

Any Federal reserve bank may at its discretion withdraw collateral deposited with the local Federal reserve agent for the protection of Federal reserve notes deposited with it and shall at the same time substitute other

collateral of equal value approved by the Federal reserve agent under regulations to be prescribed by the Federal Reserve Board

It shall be the duty of every Federal reserve bank to receive on deposit, at par and without charge for exchange or collection, checks and drafts drawn upon any of its depositors or by any of its depositors upon any other depositor and checks and drafts drawn by any depositor in any other Federal reserve bank upon funds to the credit of said depositor in said reserve bank last mentioned, nothing herein contained to be construed as prohibiting member banks from making reasonable charges to cover actual expenses incurred in collecting and remitting funds for their patrons. The Federal Reserve Board shall make and promulgate from time to time regulations governing the transfer of funds at par among Federal reserve banks, and may at its discretion exercise the functions of a clearing house for such Federal reserve banks, or may designate a Federal reserve bank to exercise such functions, and may also require each such bank to exercise the functions of a clearing house for its member banks

SEC 18 That so much of the provisions of section fifty-one hundred and fifty-nine of the Revised Statutes of the United States, and section four of the Act of June twentieth, eighteen hundred and seventy-four, and section eight of the Act of July twelfth, eighteen hundred and eighty-two, and of any other provisions of existing statutes, as require that before any national banking association shall be authorized to commence banking business it shall transfer and deliver to the Treasurer of the United States a stated amount of United States registered bonds be, and the same is hereby, repealed

REFUNDING BONDS

SEC 19 That upon application the Secretary of the Treasury shall exchange the two per centum bonds of the United States bearing the circulation privilege deposited by any national banking association with the Treasurer of the United States as security for circulating notes for three per centum bonds of the United States without the circulation privilege, payable after twenty years from date of issue, and exempt from Federal, State, and municipal taxation both as to income and principal. No national bank shall, in any one year, present two per centum bonds for exchange in the manner hereinbefore provided to an amount exceeding five per centum of the total amount of bonds on deposit with the Treasurer by said bank for circulation purposes. Should any national bank fail in any one year to so exchange its full quota of two per centum bonds under the terms of this Act, the Secretary of the Treasury may permit any other national bank or banks to exchange bonds in excess of the five per centum aforesaid in an amount equal to the deficiency caused by the failure of any one or more banks to make exchange in any one year, allotment to be made to applying banks in proportion to their holdings of bonds. At the expiration of twenty years from the passage of this Act every holder of United States two per centum

bonds then outstanding shall receive payment at par and accrued interest. After twenty years from the date of the passage of this Act national-bank notes still remaining outstanding shall be recalled and redeemed by the national banking associations issuing the same within a period and under regulations to be prescribed by the Federal Reserve Board, and notes still remaining in circulation at the end of such period shall be secured by an equal amount of lawful money to be deposited in the Treasury of the United States by the banking associations originally issuing such notes. Meanwhile every national bank may continue to apply for and receive circulating notes from the Comptroller of the Currency based upon the deposit of two per centum bonds or of any other bonds bearing the circulation privilege, but no national bank shall be permitted to issue other circulating notes except such as are secured as in this section provided or to issue or to make use of any substitute for such circulating notes in the form of clearing-house loan certificates, cashier's checks, or other obligation.

BANK RESERVES

SEC. 20 That from and after the date when the Secretary of the Treasury shall have officially announced, in such manner as he may elect, the fact that a Federal reserve bank has been established in any designated district, every banking association within said district which shall have subscribed for stock in such Federal reserve bank shall be required to establish and maintain reserves as follows:

(a) If a country bank as defined by existing law, it shall hold and maintain a reserve equal to twelve per centum of the aggregate amount of its deposits, not including savings deposits hereinafter provided for. Five-twelfths of such reserve shall consist of money which national banks may under existing law count as legal reserve, held actually in the bank's own vaults, and for a period of fourteen months from the date aforesaid at least three-twelfths and thereafter at least five-twelfths of such reserve shall consist of a credit balance with the Federal reserve bank of its district. The remainder of the twelve per centum reserve hereinbefore required may, for a period of thirty-six months from and after the date fixed by the Secretary of the Treasury as hereinbefore provided, consist of balances due from national banks in reserve or central reserve cities as now defined by law. From and after a date thirty-six months subsequent to the date fixed by the Secretary of the Treasury as hereinbefore provided the said remainder of the twelve per centum reserve required of each country bank shall consist either in whole or in part of reserve money in the bank's own vaults or of credit balance with the Federal reserve bank of its district.

(b) If a reserve city bank as defined by existing law, it shall hold and maintain, for a period of sixty days from the date fixed by the Secretary of the Treasury as hereinbefore provided, a reserve equal to twenty per centum of the aggregate amount of its deposits, not including savings de-

posits hereinafter provided for, and permanently thereafter eighteen per centum. At least one-half of such reserve shall consist of money which national banks may under existing law count as legal reserve, held actually in the bank's own vaults. After sixty days from the date aforesaid, and for a period of one year, at least three-eighths and permanently thereafter at least five-eighths of such reserve shall consist of a credit balance with the Federal reserve bank of its district. The remainder of the reserve in this paragraph required may, for a period of thirty-six months from and after the date fixed by the Secretary of the Treasury as hereinbefore provided, consist of balances due from national banks in central reserve cities as now defined by law. From and after a date thirty-six months subsequent to the date fixed by the Secretary of the Treasury as hereinbefore provided, the said remainder of the eighteen per centum reserve required of each reserve city bank shall consist either in whole or in part of reserve money in the bank's own vaults or of credit balance with the Federal reserve bank of its district.

(c) If a central reserve city bank as defined by existing law, it shall hold and maintain for a period of sixty days from the date fixed by the Secretary of the Treasury as hereinbefore provided a reserve equal to twenty per centum of the aggregate amount of its deposits, not including savings deposits hereinafter provided for, and permanently thereafter eighteen per centum. At least one-half of such reserve shall consist of money which national banks may under existing law count as legal reserve, held actually in the bank's own vaults. After sixty days from the date aforesaid, and thereafter for a period of one year, at least three-eighths and permanently thereafter at least five-eighths of such reserve shall consist of a credit balance with the Federal reserve bank of its district. The remainder of the eighteen per centum reserve required of each central reserve city bank shall consist either in whole or in part of reserve money actually held in its own vaults or of credit balance with the Federal reserve bank of its district.

SEC 21 That so much of sections two and three of the Act of June twentieth, eighteen hundred and seventy-four, entitled "An Act fixing the amount of United States notes, providing for a redistribution of the national bank currency, and for other purposes," as provides that the fund deposited by any national banking association with the Treasurer of the United States for the redemption of its notes shall be counted as a part of its lawful reserve as provided in the Act aforesaid, be, and the same is hereby, repealed. And from and after the passage of this Act such fund of five per centum shall in no case be counted by any national banking association as a part of its lawful reserve.

SEC 22 That every Federal reserve bank shall at all times have on hand in its own vaults, in gold or lawful money, a sum equal to not less than thirty-three and one-third per centum of its outstanding demand liabilities.

The Federal Reserve Board may notify any Federal reserve bank whose

lawful reserve shall be below the amount required to be kept on hand, to make good such reserve, and if such bank shall fail for thirty days thereafter so to make good its lawful reserve, the Federal Reserve Board may appoint a receiver to wind up the business of said bank

BANK EXAMINATIONS

SEC 23 That the examination of the affairs of every national banking association authorized by existing law shall take place at least twice in each calendar year and as much oftener as the Federal Reserve Board shall consider necessary in order to furnish a full and complete knowledge of its condition. The Secretary of the Treasury may, however, at any time direct the holding of a special examination. The person assigned to the making of such examination of the affairs of any national banking association shall have power to call together a quorum of the directors of such association, who shall, under oath, state to such examiner the character and circumstances of such of its loans or discounts as he may designate, and from and after the passage of this Act all bank examiners shall receive fixed salaries, the amount whereof shall be determined by the Federal Reserve Board and annually reported to Congress. But the expense of the examinations herein provided for shall be assessed by the Federal Reserve Board upon the associations examined in proportion to assets or resources held by such associations upon a date during the year in which such examinations are held to be established by the Federal Reserve Board. The Comptroller of the Currency shall so arrange the duties of national-bank examiners that no two successive examinations of any association shall be made by the same examiner.

In addition to the examinations made and conducted by the Comptroller of the Currency, every Federal reserve bank may, with the approval of the Federal Reserve Board, arrange for special or periodical examination of the member banks within its district. Such examination shall be so conducted as to inform the Federal reserve bank under whose auspices it is carried on of the condition of its member banks and of the lines of credit which are being extended by them. Every Federal reserve bank shall at all times furnish to the Federal Reserve Board such information as may be demanded by the latter concerning the condition of any national banking association located within the district of the said Federal reserve bank.

The Federal Reserve Board shall as often as it deems best, and in any case not less frequently than four times each year, order an examination of national banking associations in reserve cities. Such examinations shall show in detail the total amount of loans made by each bank on demand, on time, and the different classes of collateral held to protect the various loans, and the lines of credit which are being extended by them. The Federal Reserve Board shall, at least once each year, order an examination of each Federal reserve bank, and upon joint application of ten member banks the

Federal Reserve Board shall order a special examination and report of the condition of any Federal reserve bank

SEC 24 That no national bank shall hereafter make any loan or grant any gratuity to any examiner of such bank. Any bank offending against this provision shall be deemed guilty of a misdemeanor and shall be fined not more than \$5,000, and a further sum equal to the money so loaned or gratuity given, and the officer or officers of a bank making such loan or granting such gratuity shall be likewise deemed guilty of a misdemeanor and each shall be fined not to exceed \$5,000. Any examiner accepting a loan or gratuity from any bank examined by him shall be deemed guilty of a misdemeanor and shall be fined not more than \$5,000, and a further sum equal to the money so loaned or gratuity given, and shall forever thereafter be disqualified from holding office as a national-bank examiner. No national-bank examiner shall perform any other service for compensation while holding such office.

No officer or director of a national bank shall receive or be beneficiary, either directly or indirectly, of any fee (other than a legitimate fee paid an attorney at law for legal services), commission, gift, or other consideration for or on account of any loan, purchase, sale, payment, exchange, or transaction with respect to stocks, bonds, or other investment securities or notes, bills of exchange, acceptances, bankers' bills, cable transfers or mortgages made by or on behalf of a national bank of which he is such officer or director. Any person violating any provision of this section shall be punished by a fine of not exceeding \$5,000 or by imprisonment not exceeding five years, or both such fine and imprisonment, in the discretion of the court having jurisdiction.

Except so far as already provided in existing laws this provision shall not take effect until six months after the passage of this Act.

SEC 25 That from and after the passage of this Act the stockholders of every national banking association shall be held individually responsible for all contracts, debts, and engagements of such association, each to the amount of his stock therein, at the par value thereof in addition to the amount invested in such stock. The stockholders in any national banking association who shall have transferred their shares or registered the transfer thereof within sixty days next before the date of the failure of such association to meet its obligations shall be liable to the same extent as if they had made no such transfer, but this provision shall not be construed to affect in any way any recourse which such shareholders might otherwise have against those in whose names such shares are registered at the time of such failure. Section fifty-one hundred and fifty-one, Revised Statutes of the United States, is hereby reenacted except in so far as modified by this section.

LOANS ON FARM LANDS

SEC 26 That any national banking association not situated in a reserve city or central reserve city may make loans secured by improved and unen-

cumbered farm land, but no such loan shall be made for a longer time than twelve months, nor for an amount exceeding fifty per centum of the actual value of the property offered as security, and such property shall be situated within the Federal reserve district in which the bank is located. Any such bank may make such loans in an aggregate sum equal to twenty-five per centum of its capital and surplus.

The Federal Reserve Board shall have power from time to time to add to the list of cities in which national banks shall not be permitted to make loans secured upon real estate in the manner described in this section.

SAVINGS DEPARTMENT

SEC 27 That any national banking association may, subsequent to a date one year after the organization of the Federal Reserve Board, make application to the Comptroller of the Currency for permission to open a savings department. Such application shall set forth that the directors of said national bank have by a majority vote apportioned a specified percentage of their paid-in capital and surplus to said savings department and to that have segregated specified assets for the uses of said department, or that cash capital for the said savings department has been obtained by subscription to additional issues of the capital stock of said national bank. *Provided*, That the capital thus set apart for the uses of the proposed savings department aforesaid shall in no case be less than \$15,000, or more than a sum equal to twenty per centum of the paid-up capital and surplus of the said national bank.

In making the application aforesaid any national banking association may further apply for power to act as trustee for mortgage loans subject to the conditions and limitations herein prescribed or to be established as hereinafter provided.

Whenever the Comptroller of the Currency shall have approved any such application as hereinbefore provided, he shall so inform the applying bank, and thereafter it shall be authorized to receive savings deposits as so defined, and the organization and business conducted or possessed by said bank at the time of making said application, except such as has been specifically segregated for the savings department, and subsequent expansions thereof shall be known as the commercial department of the said bank. The said departments shall, to all intents and purposes, be separate and distinct institutions save and except as hereinafter expressly provided. The capital, surplus, deposits, securities, investments, and other property, effects, and assets of each of said departments shall, in no event, be mingled with those of the other department, or used, either in whole or in part, to pay any of the deposits of the other department until all of the deposits of its own department have been fully paid and satisfied. National banks may increase or diminish their capital stock in the manner now provided by law, but whenever such general increase or reduction of the capital stock of any national bank operating upon the provisions of this section shall be made

such increase or reduction shall be apportioned between the commercial and savings departments of the said bank as its board of directors shall prescribe, notice of such increase or reduction, and of the apportionment thereof, being forthwith given to the Comptroller of the Currency, and any such national bank may increase or diminish the capital already apportioned to either its savings or commercial department to an extent not inconsistent with the provisions of this section, notifying the Comptroller of the Currency as hereinbefore provided. The savings department for which authority has been solicited and granted shall have control of the cash or assets apportioned to it as hereinbefore provided, and shall be organized under rules and regulations to be prescribed by the Comptroller of the Currency.

Both the savings and commercial departments so created shall, however, be under the control and direction of a single board of directors and of the general officers of said bank.

All business transacted by the commercial department of any such national bank shall be in every respect subject to the limitations and requirements provided in the national banking Act as modified by this Act, and such business shall henceforward be known as commercial business.

The savings department of each such national bank shall be authorized to accumulate and loan the funds of its depositors, to receive deposits of current funds to purchase securities authorized by the Federal Reserve Board, to loan any funds in its possession upon real estate or other authorized security, and to collect the same with interest, and to declare and pay dividends or interest upon its deposits. The Federal Reserve Board is hereby authorized to exempt the savings departments of national banking associations from any and every restriction upon classes or kinds of business laid down in the national banking Act, and it shall be the duty of the said board within one year after its organization to prepare and publish rules and regulations for the conduct of business by such savings departments. The said regulations shall require every national bank which shall conduct a savings department and a commercial department to segregate in its own vaults the cash and assets belonging to such departments respectively and shall prescribe the general forms of separate books of account to be used by each such department for its exclusive and individual use. The regulations aforesaid shall further specify the period of notice for the withdrawal of deposits made in the said savings department and shall forbid the acceptance of deposits by one department of such national bank from the other department of such bank. The Federal Reserve Board shall make and publish at its discretion lists of securities, paper, bonds, and other forms of investment, which the savings departments of national banks shall be authorized to buy or loan upon, and said lists need not be uniform throughout the United States, but shall be adapted to the conditions of business in different sections of the country.

It shall be the duty of every national bank to maintain, with respect to

all deposit liabilities of its savings department, a reserve in money which may under existing law be counted as reserve, equal to not less than five per centum of the total deposit liabilities of such department, and every national bank authorized to maintain a savings department is hereby exempted from the reserve requirements of the national banking Act and of this Act in respect to the said deposit liabilities of its savings department, except as in this section provided. Every regulation made in pursuance of this section shall be duly published, and also posted in every member bank having a savings department.

Every officer, director, or employee of any member bank who shall knowingly or willfully violate any of the provisions of this section, or any of the regulations of the Federal Reserve Board, or of the Comptroller of the Currency, made under and by virtue of the provisions of this section shall be guilty of a felony, and on conviction thereof shall be punished by a fine not exceeding \$5,000 or by imprisonment not exceeding two years, or both, in the discretion of the court.

FOREIGN BRANCHES

SEC 28 That any national banking association possessing a capital of \$1,000,000 or more may file application with the Federal Reserve Board, upon such conditions and under such circumstances as may be prescribed by the said board, for the purpose of securing authority to establish branches in foreign countries for the furtherance of the foreign commerce of the United States and to act, if required to do so, as fiscal agents of the United States. Such application shall specify, in addition to the name and capital of the banking association filing it, the foreign country or countries or the dependencies of the United States where the banking operations proposed are to be carried on and the amount of capital set aside by the said banking association filing such application for the conduct of its foreign business at the branches proposed by it to be established in foreign countries. The Federal Reserve Board shall have power to approve or to reject such application if, in its judgment, the amount of capital proposed to be set aside for the conduct of foreign business is inadequate or if for other reasons the granting of such application is deemed inexpedient.

Every national banking association which shall receive authority to establish branches in foreign countries shall be required at all times to furnish information concerning the condition of such branches to the Comptroller of the Currency upon demand, and the Federal Reserve Board may order special examinations of the said foreign branches at such time or times as it may deem best. Every such national banking association shall conduct the accounts of each foreign branch independently of the accounts of other foreign branches established by it and or its home office, and shall at the end of each fiscal period transfer to its general ledger the profit or loss accruing at each such branch as a separate item.

SIC 29 That all provisions of law inconsistent with or superseded by

any of the provisions of this Act be, and the same are hereby, repealed *Provided*, That nothing in this Act contained shall be construed to repeal the parity provision or provisions contained in an Act approved March fourteenth, nineteen hundred, entitled "An Act to define and fix the standard of value, to maintain the parity of all forms of money issued or coined by the United States, to refund the public debt, and for other purposes"

SEC 30 That the right to amend, alter, or repeal this Act is hereby expressly reserved

Passed the House of Representatives September 18, 1913

Attest

SOUTH TRIMBLE,

Clerk

B SENATE BILL AS ADOPTED

IN THE SENATE OF THE UNITED STATES

December 19, 1913

Resolved, That the bill from the House of Representatives (H R 7837) entitled "An Act to provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes," do pass with the following

AMENDMENT

Strike out all after the enacting clause and insert

That the short title of this Act shall be the "Federal Reserve Act"

Wherever the word "bank" is used in this Act, the word shall be held to include State bank, banking association, and trust company, except where national banks or Federal reserve banks are specifically referred to

The terms "national bank" and "national banking association" used in this Act shall be held to be synonymous and interchangeable The term "member bank" shall be held to mean any national bank, State bank, or bank or trust company which has become a member of one of the reserve banks created by this Act The term "board" shall be held to mean Federal Reserve Board, the term "district" shall be held to mean Federal reserve district the term "reserve bank" shall be held to mean Federal reserve bank

FEDERAL RESERVE DISTRICTS

SEC 2 As soon as practicable, the Secretary of the Treasury and not less than two other members of the Federal Reserve Board hereinafter provided for, to be assigned by the President, acting as "The Reserve Bank Organization Committee," shall designate not less than eight nor more than

twelve cities to be known as Federal reserve cities, and shall divide the continental United States, including Alaska, into districts, each district to contain one, and only one, of such Federal reserve cities. The determination of said organization committee shall not be subject to review except by the Federal Reserve Board when organized. Provided, That the districts shall be apportioned with due regard to the convenience and customary course of business and shall not necessarily be coterminous with any State or States. The districts thus created may be readjusted and new districts may from time to time be created by the Federal Reserve Board, not to exceed twelve in all. Such districts shall be known as Federal reserve districts and may be designated by number. A majority of the organization committee shall constitute a quorum with authority to act.

Said organization committee shall be authorized to employ counsel and expert aid, to take testimony, to send for persons and papers, to administer oaths, and to make such investigation as may be deemed necessary by the said committee in determining the reserve districts and in determining the cities within such districts where such Federal reserve banks shall be severally located. The said committee shall supervise the organization, in each of the cities designated, of a Federal reserve bank, which shall include in its title the name of the city in which it is situated, as "Federal Reserve Bank of Chicago."

Under regulations to be prescribed by the organization committee, every national banking association in the United States is hereby required and every eligible bank in the United States and every trust company within the District of Columbia incorporated under an Act of Congress approved October first, eighteen hundred and ninety-one, is hereby authorized to signify in writing, within sixty days after the passage of this Act, its acceptance of the terms and provisions hereof. When a Federal reserve bank shall have been organized, every national banking association within that district shall be required and every eligible bank may be permitted to subscribe to the capital stock thereof in a sum equal to six per centum of the paid-up capital stock and surplus of such bank, one-sixth of the subscription to be payable on call of the organization committee or of the Federal Reserve Board, one-sixth within three months and one-sixth within six months thereafter, and the remainder of the subscription, or any part thereof, shall be subject to call when deemed necessary by the Federal Reserve Board, said payments to be in gold or gold certificates.

The shareholders of every Federal reserve bank shall be held individually responsible, equally and ratably, and not one for another, for all contracts, debts, and engagements of such bank to the extent of the amount of their subscriptions to such stock at the par value thereof in addition to the amount subscribed, whether such subscriptions have been paid up in whole or in part, under the provisions of this Act.

Any national bank failing to signify its acceptance of the terms of this

Act within the sixty days aforesaid shall cease to act as a reserve agent, upon thirty days' notice, to be given within the discretion of the said organization committee or of the Federal Reserve Board

Should any national banking association in the United States now organized fail, within one year after the passage of this Act, to become a member bank under the provisions hereinbefore stated, or fail to comply with any of the provisions of this Act applicable thereto, all of the rights, privileges, and franchises of such association granted to it under the national-bank Act, or under the provisions of this Act, shall be thereby forfeited. Any noncompliance with or violation of this Act shall, however, be determined and adjudged by any court of the United States of competent jurisdiction in a suit brought for that purpose in the district or territory in which such bank is located, under direction of the Federal Reserve Board, by the Comptroller of the Currency in his own name before the association shall be declared dissolved. In cases of such noncompliance or violation, other than the failure to become a member bank under the provisions of this Act, every director who participated in or assented to the same shall be held liable in his personal or individual capacity for all damages which said bank, its shareholders, or any other person shall have sustained in consequence of such violation.

Such dissolution shall not take away or impair any remedy against such corporation, its stockholders or officers, for any liability or penalty which shall have been previously incurred.

Should the subscriptions by banks to the stock of said Federal reserve banks or any one or more of them be, in the judgment of the organization committee, insufficient to provide the amount of capital required therefor, then and in that event the said organization committee may, under conditions and regulations to be prescribed by it, offer to public subscription at par such an amount of stock in said Federal reserve banks, or any one or more of them, as said committee shall determine, subject to the same conditions as to payment in and stock liability as provided for member banks.

No individual, copartnership, or corporation other than a member bank of its district shall be permitted to subscribe for or to hold at any time more than \$10,000 par value of stock in any Federal reserve bank. Such stock shall be known as public stock and may be transferred on the books of the Federal reserve bank by the chairman of the board of directors of such bank.

Should the total subscriptions by banks and the public to the stock of said Federal reserve banks, or any one or more of them, be, in the judgment of the organization committee, insufficient to provide the amount of capital required therefor, then and in that event the said organization committee shall allot to the United States such an amount of said stock as said committee shall determine. Said United States stock shall be paid for at par out of any money in the Treasury not otherwise appropriated, and shall

be held by the Secretary of the Treasury and disposed of for the benefit of the United States in such manner, at such times, and at such price, not less than par, as the Secretary of the Treasury shall determine

Stock not held by member banks shall not be entitled to voting power in the hands of its holders, but the voting power thereon shall be vested in and be exercised solely by the class C directors of the Federal reserve bank in which said stock may be held, and who shall be designated as "voting trustees" The voting power on said public stock shall be limited to one vote for each \$15,000 par value thereof, fractional amounts not to be considered The voting trustees shall exercise the same powers as member banks in voting for class A and class B directors

The Federal Reserve Board is hereby empowered to adopt and promulgate rules and regulations governing the transfers of said stock and the exercise of the voting power thereon

No Federal reserve bank shall commence business with a subscribed capital less in amount than \$3,000,000 The organization of reserve districts and Federal reserve cities shall not be construed as changing the present status of reserve cities and central reserve cities except in so far as this Act changes the amount of reserves that may be carried with approved reserve agents located therein The organization committee shall have power to appoint such assistants and incur such expenses in carrying out the provisions of this Act as it shall deem necessary and such expenses shall be payable by the Treasurer of the United States upon vouchers approved by the Secretary of the Treasury and the sum of \$100,000, or so much thereof as may be necessary is hereby appropriated out of any moneys in the Treasury not otherwise appropriated, for the payment of such expenses

BRANCH OFFICES

SEC 3 Each Federal reserve bank shall establish branch offices within the Federal reserve district in which it is located and also in the district of any Federal reserve bank which may have been suspended such branches to be established and conducted at places and under regulations approved by the Federal Reserve Board

FEDERAL RESERVE BANKS

SEC 4 When the organization committee shall have established Federal reserve districts as provided in section two of this Act a certificate shall be filed with the Comptroller of the Currency showing the geographical limits of such districts and the Federal reserve city designated in each of such districts The Comptroller of the Currency shall thereupon cause to be forwarded to each national bank located in each district and to such other banks declared to be eligible by the organization committee which may

apply therefor, an application blank in form to be approved by the organization committee, which blank shall contain a resolution to be adopted by the board of directors of each bank executing such application, authorizing a subscription to the capital stock of the Federal reserve bank organizing in that district in accordance with the provisions of this Act

When the minimum amount of capital stock prescribed by this Act for the organization of any Federal reserve bank shall have been subscribed and allotted the organization committee shall designate any five banks of those whose applications have been received to execute a certificate of organization, and thereupon the banks so designated shall, under their seals, make an organization certificate which shall specifically state the name of such Federal reserve bank, the territorial extent of the district over which the operations of such Federal reserve bank are to be carried on, the city and State in which said bank is to be located, the amount of capital stock and the number of shares into which the same is divided, the name and place of doing business of each bank executing such certificate, and of all banks which have subscribed to the capital stock of such Federal reserve bank and the number of shares subscribed by each, and the fact that the certificate is made to enable those banks executing same, and all banks which have subscribed or may thereafter subscribe to the capital stock of such Federal reserve bank, to avail themselves of the advantages of this Act

The said organization certificate shall be acknowledged before a judge of some court of record or notary public, and shall be, together with the acknowledgment thereof, authenticated by the seal of such court or notary, transmitted to the Comptroller of the Currency, who shall file, record, and carefully preserve the same in his office

Upon the filing of such certificate with the Comptroller of the Currency as aforesaid, the said Federal reserve bank shall become a body corporate and as such, and in the name designated in such organization certificate, shall have power—

First To adopt and use a corporate seal

Second To have succession for a period of twenty years from its organization unless it is sooner dissolved by an Act of Congress, or unless its franchise becomes forfeited by some violation of law

Third To make contracts

Fourth To sue and be sued, complain and defend, in any court of law or equity

Fifth To appoint by its board of directors, elected as hereinafter provided, such officers as are not otherwise provided for in this Act, to define their duties, require bonds of them and fix the penalty thereof, to dismiss such officers or any of them as may be appointed by them at pleasure, and to appoint others to fill their places

Sixth To prescribe by its board of directors by-laws not inconsistent

with law, regulating the manner in which its general business may be conducted, and the privileges granted to it by law may be exercised and enjoyed

Seventh To exercise by its board of directors, or duly authorized officers or agents, all powers specifically granted by the provisions of this Act and such incidental powers as shall be necessary to carry on the business of banking within the limitations prescribed by this Act

Eighth Upon deposit with the Treasurer of the United States of any bonds of the United States in the manner provided by existing law relating to national banks, to receive from the Comptroller of the Currency circulating notes in blank, registered and countersigned as provided by law, equal in amount to the par value of the bonds so deposited such notes to be issued under the same conditions and provisions of law which relate to the issue of circulating notes of national banks secured by bonds of the United States bearing the circulating privilege, except that the issue of such notes shall not be limited to the amount of the capital stock of such Federal reserve bank

But no Federal reserve bank shall transact any business except such as is incidental and necessarily preliminary to its organization until it has been authorized by the Comptroller of the Currency to commence business under the provisions of this Act

Every Federal reserve bank shall be conducted under the supervision and control of a board of directors

The board or directors shall perform the duties usually appertaining to the office of directors of banking associations and all such duties as are prescribed by law

Said board shall administer the affairs of said bank fairly and impartially and without discrimination in favor of or against any member bank or banks and shall subject to the provisions of law and the orders of the Federal Reserve Board extend to each member bank such discounts advancements and accommodations as may be safely and reasonably made with due regard for the claims and demands of other member banks

Such board of directors shall be selected as hereinafter specified and shall consist of nine members holding office for three years, and divided into three classes designated as classes A, B, and C

Class A shall consist of three members who shall be chosen by and be representative of the stock-holding banks

Class B shall consist of three members who at the time of their election shall be actively engaged in their district in commerce, in agriculture, or in some other industrial pursuit

Class C shall consist of three members, who shall be designated by the Federal Reserve Board When the necessary subscriptions to the capital stock have been obtained for the organization of any Federal reserve bank, the Federal Reserve Board shall appoint the class C directors herein pro-

vided for and shall designate one of such directors as chairman of the board to be selected. Pending designation of such chairman the organization committee shall, as provided in this section, exercise the powers and duties appertaining to the office of chairman in the organization of such Federal reserve bank.

No Senator or Representative in Congress shall be a member of the Federal Reserve Board, a director of a Federal reserve bank, or an officer or director of any member bank.

No director of class B or of class C shall be an officer, director, employee, or stockholder of any bank.

Directors of class A and class B shall be chosen in the following manner:

The chairman of the board of directors of the Federal reserve bank of the district in which the bank is situated or, pending the appointment of such chairman, the organization committee shall classify the member banks of the district into three general groups or divisions. Each group shall contain, as nearly as may be, one-third of the aggregate number of the member banks of the district, and shall consist, as nearly as may be, of banks of similar capitalization. The groups shall be designated by number by the chairman.

At a regularly called meeting of the board of directors of each member bank in the district it shall elect by ballot a district reserve elector and shall certify his name to the chairman of the board of directors of the Federal reserve bank of the district. The chairman shall establish lists of the district reserve electors thus named by banks in each of the aforesaid three groups and shall transmit one list to each elector in each group.

Every elector shall, within fifteen days after the receipt of the said list, certify to the chairman his first, second, and other choices of a director of class A and class B, respectively, upon a preferential ballot, on a form furnished by the chairman of the board of directors of the Federal reserve bank of the district. Each elector shall make a cross opposite the name of the first, second, and other choices for a director of class A and for a director of class B, but shall not vote more than one choice for any one candidate.

Any candidate having a majority of all votes cast in the column of first choice shall be declared elected. If no candidate have a majority of all the votes in the first column, then there shall be added together the votes cast by the electors for such candidates in the second column to the votes cast for the several candidates in the first column. If any candidate then have a majority of the electors voting, by adding together the first and second choices, he shall be declared elected. If no candidate have a majority of electors voting when the first and second choices shall have been added, then the votes cast in the third column for other choices shall be added together in like manner, and the candidate then having the highest number

of votes shall be declared elected. An immediate report of election shall be declared.

Three directors belonging to class C shall be appointed directly by the Federal Reserve Board, and shall have been for at least two years residents of the district for which they are appointed, one of whom shall be designated by said board as chairman of the board of directors of the Federal reserve bank of the district to which he is appointed and shall be designated by said board as "Federal reserve agent." He shall be a person of tested banking experience, and in addition to his duties as chairman of the board of directors of the Federal reserve bank of the district to which he is appointed, he shall be required to maintain under regulations to be established by the Federal Reserve Board a local office of said board, which shall be situated on the premises of the Federal reserve bank of the district. He shall make regular reports to the Federal Reserve Board, and shall act as its official representative for the performance of the functions conferred upon it by this Act. He shall receive an annual compensation to be fixed by the Federal Reserve Board and paid monthly by the Federal reserve bank to which he is designated. One of the directors of class C who shall be a person of tested banking experience shall be appointed by the Federal Reserve Board as deputy chairman and deputy Federal reserve agent to exercise the powers of the chairman of the board and Federal reserve agent in case of the absence or disability of his principal.

Directors of Federal reserve banks shall receive, in addition to any compensation otherwise provided, a reasonable allowance for necessary expenses in attending meetings of their respective boards, which amount shall be paid by the respective Federal reserve banks. Any compensation that may be provided by boards of directors of Federal reserve banks for members of such boards shall be subject to review and subsequent readjustment at any time by the Federal Reserve Board.

The Reserve Bank Organization Committee may, in organizing Federal reserve banks for the first time, call such meetings of bank directors in the several districts as may be necessary to carry out the purposes of this Act, and may exercise the functions herein conferred upon the chairman of the board of directors of each Federal reserve bank pending the complete organization of such bank.

At the first meeting of the full board of directors of each Federal reserve bank after organization it shall be the duty of the directors of classes A and B and C respectively to designate one of the members of each class whose term of office shall expire in one year from the first of January nearest to date of such meeting, one whose term of office shall expire at the end of two years from said date and one whose term of office shall expire at the end of three years from said date. Thereafter every director of a Federal reserve bank chosen as heretofore provided shall hold office for a term of three years. Vacancies that may occur in the

several classes of directors of Federal reserve banks may be filled in the manner provided for the original selection of such directors, such appointees to hold office for the unexpired terms of their predecessors

STOCK ISSUES, INCREASE AND DECREASE OF CAPITAL

SEC 5 The capital stock of each Federal reserve bank shall be divided into shares of \$100 each. The outstanding capital stock shall be increased from time to time as member banks increase their capital stock and surplus or as additional banks become members, and may be decreased as member banks reduce their capital stock or surplus or cease to be members. Shares of the capital stock of Federal reserve banks owned by member banks shall not be transferable, nor be hypothecable. In case a member bank increase its capital stock or surplus, it shall thereupon subscribe for an additional amount of capital stock of the Federal reserve bank of its district equal to six per centum of the said increase, one-half of said subscription to be paid in the manner heretofore provided for original subscription, and one-half subject to call of the Federal Reserve Board. A bank applying for stock in a Federal reserve bank at any time after the organization thereof must subscribe for an amount of the capital stock of the Federal reserve bank equal to six per centum of the paid-up capital stock and surplus of said applicant bank, paying therefor its par value plus one-half of one per centum a month from the period of the last dividend. When the capital stock of any Federal reserve bank shall have been increased either on account of the increase of capital stock of member banks or on account of the increase in the number of member banks, the board of directors shall cause to be executed a certificate to the Comptroller of the Currency showing the increase in capital stock, the amount paid in, and by whom paid. In case a member bank reduces its capital stock it shall surrender a proportionate amount of its holdings in the capital of said Federal reserve bank, and in case a member bank goes into voluntary liquidation it shall surrender all of its holdings of the capital stock of said Federal reserve bank and be released from its stock subscription not previously called. In either case the shares surrendered shall be canceled and such member bank shall receive in payment therefor, under regulations to be prescribed by the Federal Reserve Board, a sum equal to its cash paid subscriptions on the shares surrendered and one-half of one per centum a month from the period of the last dividend, not to exceed the book value thereof, less any liability of such member bank to the Federal reserve bank.

SEC 6 If any member bank shall be declared insolvent and a receiver appointed therefor, the stock held by it in said Federal reserve bank shall be canceled, and all cash-paid subscriptions on said stock, with one-half of one per centum per month from the period of last dividend, not to exceed the book value thereof, shall be first applied to all debts of the insolvent member bank to the Federal reserve bank, and the balance, if any, shall be

paid to the receiver of the insolvent bank Whenever the capital stock of a Federal reserve bank is reduced, either on account of a reduction in capital stock of any member bank or of the liquidation or insolvency of such bank, the board of directors shall cause to be executed a certificate to the Comptroller of the Currency showing such reduction of capital stock and the amount repaid to such bank

DIVISION OF EARNINGS

SEC 7 After all necessary expenses of a Federal reserve bank have been paid or provided for, the stockholders shall be entitled to receive an annual dividend of six per centum on the paid-in capital stock, which dividend shall be cumulative One-half of the net earnings, after the aforesaid dividend claims have been fully met, shall be paid into a surplus fund until such fund shall amount to forty per centum of the paid-in capital stock of such bank, and of the remaining one-half fifty per centum shall be paid to the United States as a franchise tax, and fifty per centum shall be paid to the United States as a trustee for the benefit of depositors in all failed member banks in the United States and failed member trust companies in the District of Columbia the money to be kept in and losses from failures to be paid from it as a depositors' insurance fund under a division of the Treasury to be constituted and managed under such regulations as may be prescribed by the Secretary of the Treasury Whenever the Secretary of the Treasury out of said fund shall pay any amounts due to depositors of failed member banks, the Secretary or the Treasury shall be subrogated to all the rights of said depositors, and in the settlement of the affairs of any such bank all dividends that would have been due to such depositors shall be paid to the Secretary of the Treasury, and the same shall be by him paid into and become a part of said depositors insurance fund All net earnings derived by the United States from Federal reserve banks shall, in the discretion of the Secretary be used to supplement the gold reserve held against outstanding United States notes or shall be applied to the reduction of the outstanding bonded indebtedness of the United States, under regulations to be prescribed by the Secretary of the Treasury Should a Federal reserve bank be dissolved or go into liquidation, any surplus remaining, after the payment of all debts dividend requirements as hereinbefore provided, and the par value of the stock, shall be paid to and become the property of the United States and shall be similarly applied

Every Federal reserve bank incorporated under the terms of this Act, the capital stock and surplus therein and the income derived therefrom shall be exempt from Federal, State, and local taxation, except in respect to taxes upon real estate

SEC 8 That section fifty-one hundred and fifty-four, United States Revised Statutes, be amended to read as follows

'Any bank incorporated by special law of any State or of the United

States or organized under the general laws of any State or of the United States and having an unimpaired capital sufficient to entitle it to become a national banking association under the provisions of the existing laws may, by the vote of the shareholders owning not less than fifty-one per centum of the capital stock of such bank or banking association, with the approval of the Comptroller of the Currency, be converted into a national banking association, with any name approved by the Comptroller of the Currency. Provided, however, That said conversion shall not be in contravention of the State law. In such case the articles of association and organization certificate may be executed by a majority of the directors of the bank or banking institution, and the certificate shall declare that the owners of fifty-one per centum of the capital stock have authorized the directors to make such certificate and to change or convert the bank or banking institution into a national association. A majority of the directors, after executing the articles of association and the organization certificate, shall have power to execute all other papers and to do whatever may be required to make its organization perfect and complete as a national association. The shares of any such bank may continue to be for the same amount each as they were before the conversion, and the directors may continue to be directors of the association until others are elected or appointed in accordance with the provisions of the statutes of the United States. When the Comptroller has given to such bank or banking association a certificate that the provisions of this Act have been complied with, such bank or banking association, and all its stockholders, officers, and employees, shall have the same powers and privileges, and shall be subject to the same duties, liabilities, and regulations, in all respects, as shall have been prescribed by the Federal reserve Act and by the national banking Act for associations originally organized as national banking associations."

STATE BANKS AS MEMBERS

SEC 9 Any bank incorporated by special law of any State, or organized under the general laws of any State or of the United States, may make application to the reserve bank organization committee, pending organization, and thereafter to the Federal Reserve Board or the right to subscribe to the stock of the Federal reserve bank organized or to be organized within the Federal reserve district where the applicant is located. The organization committee or the Federal Reserve Board, under such rules and regulations as it may prescribe, subject to the provisions of this section, may permit the applying bank to become a stockholder in the Federal reserve bank of the district in which the applying bank is located. Whenever the organization committee or the Federal Reserve Board shall permit the applying bank to become a stockholder in the Federal reserve bank of the district, stock shall be issued and paid for under the rules and regulations in this Act pro-

vided for national banks which become stockholders in Federal reserve banks

The organization committee or the Federal Reserve Board shall establish by-laws for the general government of its conduct in acting upon applications made by the State banks and banking associations and trust companies for stock ownership in Federal reserve banks. Such by-laws shall require applying banks not organized under Federal law to comply with the reserve and capital requirements and to submit to the examination and regulations prescribed by the organization committee or by the Federal Reserve Board. No applying bank shall be admitted to membership in a Federal reserve bank unless it possesses a paid-up unimpaired capital sufficient to entitle it to become a national banking association in the place where it is situated, under the provisions of the national banking Act.

Any bank becoming a member of a Federal reserve bank under the provisions of this section shall, in addition to the regulations and restrictions herenbefore provided, be required to conform to the provisions of law imposed on the national banks respecting the limitation of liability which may be incurred by any person, firm, or corporation to such banks, the prohibition against making purchase of or loans on stock of such banks, and the withdrawal or impairment of capital, or the payment of unearned dividends, and to such rules and regulations as the Federal Reserve Board may, in pursuance thereof, prescribe.

Such banks, and the officers, agents, and employees thereof, shall also be subject to the provisions of and to the penalties prescribed by sections fifty-one hundred and ninety-eight, fifty-two hundred, fifty-two hundred and one, and fifty-two hundred and eight and fifty-two hundred and nine of the Revised Statutes. The member banks shall also be required to make reports of the conditions and of the payments of dividends to the Comptroller, as provided in sections fifty-two hundred and eleven and fifty-two hundred and twelve of the Revised Statutes and shall be subject to the penalties prescribed by section fifty-two hundred and thirteen for the failure to make such report.

If at any time it shall appear to the Federal Reserve Board that a banking association or trust company organized under the laws of any State or of the United States and having become a member bank has failed to comply with the provisions of this section or the regulations of the Federal Reserve Board, it shall be within the power of the said board, after hearing to require such banking association or trust company to surrender its stock in the Federal reserve bank. Upon such surrender the Federal reserve bank shall pay the cash-paid subscriptions to the said stock with interest at the rate of one-half of one per centum per month, computed from the last dividend earned not to exceed the book value thereof, less any liability to said Federal reserve bank, except the subscription liability not previously called which shall be cancelled and said Federal reserve bank shall, upon

notice from the Federal Reserve Board, be required to suspend said banking association or trust company from further privileges of membership, and shall within thirty days of such notice cancel and retire its stock and make payment therefor in the manner herein provided. The Federal Reserve Board may restore membership upon due proof of compliance with the conditions imposed by this section.

FEDERAL RESERVE BOARD

SEC 10 A Federal Reserve Board is hereby created which shall consist of seven members, including the Secretary of the Treasury, who shall be a member ex officio, and six members appointed by the President of the United States, by and with the advice and consent of the Senate. In selecting the six appointive members of the Federal Reserve Board, not more than one of whom shall be selected from any one Federal reserve district, the President shall have due regard to a fair representation of the different geographical divisions of the country. The six members of the Federal Reserve Board appointed by the President and confirmed as aforesaid shall devote their entire time to the business of the Federal Reserve Board and shall each receive an annual salary of \$12,000, together with actual necessary traveling expenses. The members of said board, the Secretary of the Treasury, the Assistant Secretary of the Treasury, and the Comptroller of the Currency shall be ineligible during the time they are in office and for two years thereafter to hold any office, position, or employment conferred by any member bank. Of the six members thus appointed by the President at least two shall be persons experienced in banking or finance. One shall be designated by the President to serve for one, one for two, one for three, one for four, one for five, and one for six years, and thereafter each member so appointed shall serve for a term of six years unless sooner removed for cause by the President. Of the six persons thus appointed, one shall be designated by the President as governor and one as vice governor of the Federal Reserve Board. The governor of the Federal Reserve Board, subject to its supervision, shall be the active executive officer. The Secretary of the Treasury may assign offices in the Department of the Treasury for the use of the Federal Reserve Board. Each member of the Federal Reserve Board shall within fifteen days after notice of appointment make and subscribe to the oath of office.

The Federal Reserve Board shall have power to levy semiannually upon the Federal reserve banks, in proportion to their capital stock and surplus, an assessment sufficient to pay its estimated expenses and salaries of its members and employees for the half year succeeding the levying of such assessment, together with any deficit carried forward from the preceding half year.

The first meeting of the Federal Reserve Board shall be held in Washington, District of Columbia, as soon as may be after the passage of this

Act, at a date to be fixed by the Reserve Bank Organization Committee. The Secretary of the Treasury shall be ex officio chairman of the Federal Reserve Board. No member of the Federal Reserve Board shall be an officer or director of any bank, banking institution, trust company, or Federal reserve bank nor hold stock in any bank, banking institution, or trust company, and before entering upon his duties as a member of the Federal Reserve Board he shall certify under oath to the Secretary of the Treasury that he has complied with this requirement. Whenever a vacancy shall occur, other than by expiration of term, among the six members of the Federal Reserve Board appointed by the President, as above provided, a successor shall be appointed by the President, with the advice and consent of the Senate, to fill such vacancy, and when appointed he shall hold office for the unexpired term of the member whose place he is selected to fill.

The President shall have power to fill all vacancies that may happen on the Federal Reserve Board during the recess of the Senate, by granting commissions which shall expire at the end of the next session of the Senate.

Nothing in this Act contained shall be construed as taking away any powers heretofore vested by law in the Secretary of the Treasury which relate to the supervision, management, and control of the Treasury Department and bureaus under such department, and wherever any power vested by this Act in the Federal Reserve Board or the Federal reserve agent appears to conflict with the powers of the Secretary of the Treasury, such powers shall be exercised subject to the supervision and control of the Secretary.

The Federal Reserve Board shall annually make a full report of its operations to the Speaker of the House of Representatives, who shall cause the same to be printed for the information of the Congress.

Section three hundred and twenty-four of the Revised Statutes of the United States shall be amended so as to read as follows: "There shall be in the Department of the Treasury a bureau charged with the execution of all laws passed by Congress relating to the issue and regulation of national currency secured by United States bonds and, under the general supervision of the Federal Reserve Board, of all Federal reserve notes, the chief officer of which bureau shall be called the Comptroller of the Currency and shall perform his duties under the general directions of the Secretary of the Treasury."

SEC 11 The Federal Reserve Board shall be authorized and empowered

(a) To examine at its discretion the accounts, books, and affairs of each Federal reserve bank and of each member bank and to require such statements and reports as it may deem necessary. The said board shall publish once each week a statement showing the condition of each Federal reserve bank and a consolidated statement for all Federal reserve banks. Such statements shall show in detail the assets and liabilities of the Federal reserve banks, single and combined, and shall furnish full information regarding the character of the money held as reserve and the amount, nature,

and maturities of the paper and other investments owned or held by Federal reserve banks

(b) To permit or require Federal reserve banks to rediscount the discounted paper of other Federal reserve banks at rates of interest to be fixed each week or oftener by the Federal Reserve Board

(c) To suspend for a period not exceeding thirty days, and from time to time to renew such suspension for periods not exceeding fifteen days, any reserve requirement specified in this Act Provided, That it shall establish a graduated tax upon the amounts by which the reserve requirements of this Act may be permitted to fall below the level hereinafter specified And provided further, That when the gold reserve held against Federal reserve notes falls below forty per centum, the Federal Reserve Board shall establish a graduated tax of not more than one per centum upon such deficiency until the reserves fall to thirty-two and one-half per centum, and when said reserve falls below thirty-two and one-half per centum, a tax at the rate increasingly of not less than one and one-half per centum upon each two and one-half per centum or fraction thereof that such reserve falls below thirty-two and one-half per centum The tax shall be paid by the reserve bank, but the reserve bank shall add an amount equal to said tax to the rates of interest and discount fixed by the Federal Reserve Board

(d) To supervise and regulate through the bureau under the charge of the Comptroller of the Currency the issue and retirement of Federal reserve notes, and to prescribe rules and regulations under which such notes may be delivered by the Comptroller to the Federal reserve agents applying therefor

(e) To add to the number of cities classified as reserve and central reserve cities under existing law in which national banking associations are subject to the reserve requirements set forth in section twenty of this Act, or to reclassify existing reserve and central reserve cities or to terminate their designation as such

(f) To suspend or remove any officer or director of any Federal reserve bank, the cause of such removal to be forthwith communicated in writing by the Federal Reserve Board to the removed officer or director and to said bank

(g) To require the writing off of doubtful or worthless assets upon the books and balance sheets of Federal reserve banks

(h) To suspend, for cause relating to violation of any of the provisions of this Act, the operations of any Federal reserve bank and take possession thereof and administer the same during the period of suspension

(i) To require bonds of Federal reserve agents, perform the duties, functions, or services specified or implied in this Act, and to make all rules and regulations necessary to enable said board effectively to perform the same

(j) To exercise general supervision over said Federal reserve banks

(k) To authorize member banks to use, as reserves, Federal reserve notes, or bank notes based on United States bonds, to the extent that said board may find necessary

(l) To grant by special permit to national banks applying therefor, when not in contravention of State or local law, the right to act as trustee, executor, administrator, or registrar of stocks and bonds under such rules and regulations as the said board may prescribe

(m) To employ such attorneys, experts, assistants, clerks, or other employees as may be deemed necessary to properly conduct the business of such board, and to accomplish the purposes of this Act. All salaries, allowances, and expenses of those employed to be fixed in advance by said board and to be paid in the same manner as the salaries of the members of said board. All such attorneys, experts, assistants, clerks, and other employees to be appointed without regard to the provisions of the Act of January sixth, eighteen hundred and eighty-three (Twenty-second Revised Statutes, four hundred and three), and amendments thereto, or any rule or regulation made in pursuance thereof. Provided, That nothing herein shall prevent the President from placing said employees in the classified service

FEDERAL ADVISORY COUNCIL

SEC 12 There is hereby created a Federal Advisory Council, which shall consist of as many members as there are Federal reserve districts. Each Federal reserve bank by its board of directors shall annually select from its own Federal reserve district one member of said council, who shall receive such compensation and allowances as may be fixed by his board of directors subject to the approval of the Federal Reserve Board. The meetings of said advisory council shall be held at Washington, District of Columbia, at least four times each year, and oftener if called by the Federal Reserve Board. The council may in addition to the meetings above provided for hold such other meetings in Washington, District of Columbia, or elsewhere, as it may deem necessary, may select its own officers and adopt its own methods of procedure, and a majority of its members shall constitute a quorum for the transaction of business. Vacancies in the council shall be filled by the respective reserve banks, and members selected to fill vacancies shall serve for the unexpired term.

The Federal Advisory Council shall have power by itself or through its officers, (1) to confer directly with the Federal Reserve Board on general business conditions, (2) to make oral or written representations concerning matters within the jurisdiction of said board, (3) to call for information and to make recommendations in regard to discount rates, rediscount business, note issues, reserve conditions in the various districts, the purchase and sale of gold or securities by reserve banks, open-market operations by said banks and the general affairs of the reserve banking system.

POWERS OF FEDERAL RESERVE BANKS

SEC 13 Any Federal reserve bank may receive from any of its member banks, and from the United States, deposits of current funds in lawful money, national-bank notes, Federal reserve notes, or checks and drafts upon solvent banks of the Federal reserve system, payable upon presentation, or, solely for exchange purposes, may receive from other Federal reserve banks deposits of current funds in lawful money, national-bank notes, or checks and drafts upon solvent member or other Federal reserve banks, payable upon presentation

Upon the indorsement of any of its member banks, with a waiver of demand notice and protest by such bank any Federal reserve bank may discount notes, drafts, and bills of exchange arising out of actual commercial transactions, that is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes, the Federal Reserve Board to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this Act Nothing in this Act contained shall be construed to prohibit such notes, drafts, and bills of exchange, secured by staple agricultural products, or other goods, wares, or merchandise from being eligible for such discount, but such definition shall not include notes, drafts, or bills covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States Notes, drafts, and bills admitted to discount under the terms of this paragraph must have a maturity at the time of discount of not more than ninety days Provided, That notes, drafts, and bills drawn or issued for agricultural purposes or based on live stock and having a maturity not exceeding six months may be discounted in an amount to be limited to a percentage of the capital of the Federal reserve bank, to be ascertained and fixed by the Federal Reserve Board

Any Federal reserve bank may discount acceptances which are based on the importation or exportation or domestic shipment of goods and which have a maturity at time of discount of not more than three months, and indorsed by at least one member bank The amount of acceptances so discounted shall at no time exceed one-half the paid up capital stock and surplus of the bank for which the rediscounts are made

The aggregate of such notes and bills bearing the signature or indorsement of any one person, company, firm, or corporation rediscounted for any one bank shall at no time exceed ten per centum of the unimpaired capital and surplus of said bank, but this restriction shall not apply to the discount of bills of exchange drawn in good faith against actually existing values

Any national bank may accept drafts or bills of exchange drawn upon it and growing out of transactions involving the importation, exportation, or domestic shipment of goods having not more than six months sight to

run, but no bank shall accept such bills to an amount equal at any time in the aggregate to more than one-half its paid-up capital stock and surplus.

Section fifty-two hundred and two of the Revised Statutes of the United States is hereby amended so as to read as follows: No association shall at any time be indebted, or in any way liable, to an amount exceeding the amount of its capital stock at such time actually paid in and remaining undiminished by losses or otherwise, except on account of demands of the nature following:

First Notes of circulation

Second Moneys deposited with or collected by the association

Third Bills of exchange or drafts drawn against money actually on deposit to the credit of the association, or due thereto

Fourth Liabilities to the stockholders of the association for dividends and reserve profits

Fifth Liabilities incurred under the provisions of this Act

The Federal Reserve Board may authorize the reserve bank of the district to discount the direction obligations of member banks, secured by the pledge and deposit of satisfactory securities, but in no case shall the amount so loaned by a Federal reserve bank exceed three-fourths of the actual value of the securities so pledged.

The rediscount by any Federal reserve bank of any bills receivable and of domestic and foreign bills of exchange and acceptances shall be subject to such restrictions, limitations, and regulations as may be imposed by the Federal Reserve Board.

OPEN-MARKET OPERATIONS

SEC. 14 Any Federal reserve bank may, under rules and regulations prescribed by the Federal Reserve Board, purchase and sell in the open market, at home or abroad, either from or to domestic or foreign banks, firms, corporations or individuals cable transfers and bankers' acceptances and bills of exchange of the kinds and maturities by this Act made eligible for rediscount with or without the indorsement of a member bank.

Every Federal reserve bank shall have power

(a) To deal in gold coin and bullion at home or abroad, to make loans thereon exchange Federal reserve notes for gold, gold coin or gold certificates and to contract for loans of gold coin or bullion, giving therefor, when necessary, acceptable security including the hypothecation of United States bonds or other securities which Federal reserve banks are authorized to hold.

(b) To buy and sell, at home or abroad bonds and notes of the United States and bills, notes, revenue bonds, and warrants with a maturity from date of purchase of not exceeding six months, issued in anticipation of the collection of taxes or in anticipation of the receipt of assured revenues by any State, county, district, political subdivision, or municipality in the con-

continental United States, such purchases to be made in accordance with rules and regulations prescribed by the Federal Reserve Board,

(c) To purchase from member banks and to sell, with or without its indorsement, bills of exchange arising out of commercial transactions, as heretofore defined,

(d) To establish from time to time, subject to review and determination of the Federal Reserve Board, rates of discount to be charged by the Federal reserve bank for each class of paper, which shall be fixed with a view of accommodating commerce and business,

(e) To establish accounts with other Federal reserve banks for exchange purposes and, with the consent of the Federal Reserve Board, to open and maintain banking accounts in foreign countries, appoint correspondents, and establish agencies in such countries wheresoever it may deem best for the purpose of purchasing, selling, and collecting bills of exchange, and to buy and sell with or without its indorsement, through such correspondents or agencies, bills of exchange arising out of actual commercial transactions which have not more than ninety days to run and which bear the signature of two or more responsible parties

GOVERNMENT DEPOSITS

SEC 15 The moneys held in the general fund of the Treasury, except the five per centum fund for the redemption of outstanding national-bank notes and the funds provided in this Act for the redemption of Federal reserve notes may, upon the direction of the Secretary of the Treasury, be deposited in Federal reserve banks, which banks, when required by the Secretary of the Treasury, shall act as fiscal agents of the United States, and the revenues of the Government or any part thereof may be deposited in such banks, and disbursements may be made by checks drawn against such deposits

No public funds of the Philippine Islands, or of the postal savings, or any Government funds, shall be deposited in the continental United States in any bank not belonging to the system established by this Act. Provided, however, That nothing in this Act shall be construed to deny the right of the Secretary of the Treasury to use member banks as depositories

NOTE ISSUES

SEC 16 Federal reserve notes, to be issued at the discretion of the Federal Reserve Board for the purpose of making advances to Federal reserve banks through the Federal reserve agents as hereinafter set forth and for no other purpose, are hereby authorized. The said notes shall be obligations of the United States and shall be receivable by all national and member banks and Federal reserve banks and for all taxes, customs, and other public dues. They shall be redeemed in gold on demand at the Treasury

Department of the United States, in the city of Washington, District of Columbia, or in gold or lawful money at any Federal reserve bank

Any Federal reserve bank may make application to the local Federal reserve agent for such amount of the Federal reserve notes hereinbefore provided for as it may require. Such application shall be accompanied with a tender to the local Federal reserve agent of collateral in amount equal to the sum of the Federal reserve notes thus applied for and issued pursuant to such application. The collateral security thus offered shall be notes and bills accepted for rediscount under the provisions of section thirteen of this Act, and the Federal reserve agent shall each day notify the Federal Reserve Board of all issues and withdrawals of Federal reserve notes to and by the Federal reserve bank to which he is accredited. The said Federal Reserve Board shall be authorized at any time to call upon a Federal reserve bank for additional security to protect the Federal reserve notes issued to it.

Every Federal reserve bank shall maintain reserves in gold or lawful money of not less than thirty-five per centum against its deposits and its Federal reserve notes in actual circulation, but the amount of gold in the Federal reserve bank together with the amount deposited by it with the Treasury, shall be at least equal to forty per centum of the Federal reserve notes issued to said bank and in actual circulation and not offset by gold or lawful money deposited with the Federal reserve agent. Notes so paid out shall bear upon their faces a distinctive letter and serial number, which shall be assigned by the Federal Reserve Board to each Federal reserve bank. Whenever Federal reserve notes issued through one Federal reserve bank shall be received by another Federal reserve bank they shall be promptly returned for credit or redemption to the Federal reserve bank through which they were originally issued. No Federal reserve bank shall pay out notes issued through another under penalty of a tax of ten per centum upon the face value of notes so paid out. Notes presented for redemption at the Treasury of the United States shall be paid out of the redemption fund and returned to the Federal reserve banks through which they were originally issued, and thereupon such Federal reserve bank shall, upon demand of the Secretary of the Treasury, reimburse such redemption fund in lawful money or, if such Federal reserve notes have been redeemed by the Treasurer in gold or gold certificates, then such funds shall be reimbursed to the extent deemed necessary by the Secretary of the Treasury in gold or gold certificates, and such Federal reserve bank shall, so long as any of its Federal reserve notes remain outstanding, maintain with the Treasurer in gold an amount sufficient in the judgment of the Secretary to provide for all redemptions to be made by the Treasurer. Federal reserve notes received by the Treasury, otherwise than for redemption, may be exchanged for gold out of the redemption fund hereinafter provided and returned to the reserve bank through which they were origi-

nally issued, or they may be returned to such bank for the credit of the United States Federal reserve notes unfit for circulation shall be returned by the Federal reserve agents to the Comptroller of the Currency for cancellation and destruction

The Federal Reserve Board shall require each Federal reserve bank to maintain on deposit in the Treasury of the United States a sum in gold sufficient in the judgment of the Secretary of the Treasury for the redemption of the Federal reserve notes issued to such bank, but in no event less than five per centum, but such deposit of gold shall be counted and included as part of the thirty-three and one-third per centum reserve hereinbefore required The board shall have the right, acting through the Federal reserve agent, to grant in whole or in part or to reject entirely the application of any Federal reserve bank for Federal reserve notes, but to the extent that such application may be granted the Federal Reserve Board shall, through its local Federal reserve agent, supply Federal reserve notes to the bank so applying, and such bank shall be charged with the amount of such notes and shall pay such rate of interest on said amount as may be established by the Federal Reserve Board, and the amount of such Federal reserve notes so issued to any such bank shall, upon delivery, together with such notes of such Federal reserve bank as may be issued under section eighteen of this Act upon security of United States two per centum Government bonds, become a first and paramount lien on all the assets of such bank

Any Federal reserve bank may at any time reduce its liability for outstanding Federal reserve notes by depositing, with the Federal reserve agent, its Federal reserve notes, gold, gold certificates, or lawful money of the United States Federal reserve notes so deposited shall not be re-issued, except upon compliance with the conditions of an original issue

The Federal reserve agent shall hold such gold, gold certificates, or lawful money available exclusively for exchange for the outstanding Federal reserve notes when offered by the reserve bank of which he is a director Upon the request of the Secretary of the Treasury the Federal Reserve Board shall require the Federal reserve agent to transmit so much of said gold to the Treasury of the United States as may be required for the exclusive purpose of the redemption of such notes

Any Federal reserve bank may at its discretion withdraw collateral deposited with the local Federal reserve agent for the protection of its Federal reserve notes deposited with it and shall at the same time substitute therefor other like collateral of equal amount with the approval of the Federal reserve agent under regulations to be prescribed by the Federal Reserve Board

In order to furnish suitable notes for circulation as Federal reserve notes, the Comptroller of the Currency shall, under the direction of the Secretary of the Treasury, cause plates and dies to be engraved in the best

manner to guard against counterfeits and fraudulent alterations, and shall have printed therefrom and numbered such quantities of such notes of the denominations of \$1, \$2, \$5, \$10, \$20, \$50, \$100, as may be required to supply the Federal reserve banks. Such notes shall be in form and tenor as directed by the Secretary of the Treasury under the provisions of this Act and shall bear the distinctive numbers of the several Federal reserve banks through which they are issued.

When such notes have been prepared, they shall be deposited in the Treasury, or in the subtreasury or mint of the United States nearest the place of business of each Federal reserve bank, and shall be held for the use of such bank subject to the order of the Comptroller of the Currency for their delivery, as provided by this Act.

The plates and dies to be procured by the Comptroller of the Currency for the printing of such circulating notes shall remain under his control and direction, and the expenses necessarily incurred in executing the laws relating to the procuring of such notes, and all other expenses incidental to their issue and retirement, shall be paid by the Federal reserve banks, and the Federal Reserve Board shall include in its estimate of expenses levied against the Federal reserve banks a sufficient amount to cover the expenses herein provided for.

The examination of plates, dies, bed pieces, and so forth, and regulations relating to such examination of plates, dies, and so forth, of national bank notes provided for in section fifty-one hundred and seventy-four, Revised Statutes, is hereby extended to include Federal reserve notes herein provided for.

Any appropriation heretofore made out of the general funds of the Treasury for engraving plates and dies, the purchase of distinctive paper, or to cover any other expense in connection with the printing of national bank notes or notes provided for by the Act of May thirtieth, nineteen hundred and eight, and any distinctive paper that may be on hand at the time of the passage of this Act may be used in the discretion of the Secretary for the purposes of this Act, and should the appropriations heretofore made be insufficient to meet the requirements of this Act in addition to circulating notes provided for by existing law, the Secretary is hereby authorized to use so much of any funds in the Treasury not otherwise appropriated for the purpose of furnishing the notes aforesaid. Provided, however, That nothing in this section contained shall be construed as exempting national banks or Federal reserve banks from their liability to reimburse the United States for any expenses incurred in printing and issuing circulating notes.

Every Federal reserve bank shall receive on deposit from member banks or from Federal reserve banks checks and drafts drawn upon any of its depositors, and when remitted by a Federal reserve bank, checks and drafts drawn by any depositor in any other Federal reserve bank or member bank

upon funds to the credit of said depositor in said reserve bank or member bank. Nothing herein contained shall be construed as prohibiting a member bank from making reasonable charges for checks and drafts so debited to its account, or for collecting and remitting funds, or for exchange sold to its patrons. The Federal Reserve Board may, by rule, fix the charges to be collected by the member banks from its patrons whose checks are cleared through the Federal reserve bank and the charge which may be imposed for the service of clearing or collection rendered by the Federal reserve bank.

The Federal Reserve Board shall make and promulgate from time to time regulations governing the transfer of funds and charges therefor among Federal reserve banks and their branches, and may at its discretion exercise the functions of a clearing house for such Federal reserve banks, or may designate a Federal reserve bank to exercise such functions, and may also require each such bank to exercise the functions of a clearing house for its member banks.

SEC. 17 That so much of the provisions of section fifty-one hundred and fifty-nine of the Revised Statutes of the United States, and section four of the Act of June twentieth, eighteen hundred and seventy-four, and section eight of the Act of July twelfth, eighteen hundred and eighty-two, and of any other provisions of existing statutes, as require that before any national banking association shall be authorized to commence banking business it shall transfer and deliver to the Treasurer of the United States a stated amount of United States registered bonds be, and the same is hereby, repealed.

SEC. 18 Any member bank desiring to retire the whole or any part of its circulating notes may file with the Treasurer of the United States an application to sell for its account, at par and interest, United States bonds securing circulation to be retired.

The Treasurer shall, at the end of each quarterly period, furnish the Federal Reserve Board with a list of such applications, and the Federal Reserve Board may, in its discretion, require the Federal reserve banks to purchase such bonds from the banks whose applications have been filed with the Treasurer at least ten days before the end of any quarterly period at which the Federal Reserve Board may direct the purchase to be made. Upon notice from the Treasurer of the amount of bonds so sold for its account, each member bank shall duly assign and transfer, in writing, such bonds to the Federal reserve bank purchasing the same, and such Federal reserve bank shall thereupon deposit lawful money with the Treasurer of the United States for the purchase price of such bonds, and the Treasurer shall pay to the member bank selling such bonds any balance due after deducting a sufficient sum to redeem its outstanding notes secured by such bonds, which notes shall be canceled and permanently retired when redeemed.

The Federal reserve banks purchasing such bonds shall be required to take out an amount of circulating notes equal to the amount of national-bank notes outstanding against such bonds

Upon the deposit with the Treasurer of the United States bonds so purchased, or any bonds with the circulating privilege acquired under section four of this Act, any Federal reserve bank making such deposit in the manner provided by existing law shall be entitled to receive from the Comptroller of the Currency circulating notes in blank, registered and countersigned as provided by law, equal in amount to the par value of the bonds so deposited. Such notes shall be the obligations of the Federal reserve bank procuring same, and shall be in form prescribed by the Secretary of the Treasury, and to the same tenor and effect as national-bank notes now provided by law. They shall be issued and redeemed under the same terms and conditions as national-bank notes. United States bonds bought by a Federal reserve bank against which there are no outstanding national-bank notes may be exchanged at the Treasury for one-year gold notes bearing three per centum interest. In case of such exchange for one-year notes the reserve bank shall be bound to pay such notes and to receive in payment thereof new three per centum one-year Treasury gold notes year by year for the period of twenty years.

BANK RESERVES

SEC. 19 Demand liabilities within the meaning of this Act shall comprise all liabilities maturing or payable within thirty days, and time deposits shall comprise all deposits payable after thirty days, and all savings accounts and certificates of deposit which are subject to not less than thirty days' notice before payment.

When the Secretary of the Treasury shall have officially announced, in such manner as he may elect, the establishment of a Federal reserve bank in any district, every subscribing member bank shall establish and maintain reserves as follows:

(a) A bank not in a reserve or central reserve city as now or hereafter defined shall hold and maintain reserves equal to twelve per centum of the aggregate amount of its demand liabilities and five per centum of its time deposits, as follows:

In its vaults for a period of twenty-four months after said date four-twelfths thereof.

In the Federal reserve bank of its district, for a period of six months after said date, two-twelfths, and for each succeeding six months an additional one-twelfth, until five-twelfths have been so deposited, which shall be the amount permanently required.

For a period of twenty-four months after said date the balance of the reserves may be held in its own vaults, or in the Federal reserve bank, or in banks in reserve or central reserve cities as now defined by law.

After said twenty-four months' period said reserves, other than those herenbefore required to be held in the reserve bank, shall be held in the vaults of the member bank or in the Federal reserve bank, or in both, at its option

(b) A bank in a reserve city, as now or hereafter defined, shall hold and maintain reserves equal to fifteen per centum of the aggregate amount of its demand liabilities and five per centum of its time deposits, as follows

In its vaults six-fifteenths thereof

In the Federal reserve bank of its district for a period of six months after the date aforesaid at least three-fifteenths, and for each succeeding six months an additional one-fifteenth, until six-fifteenths have been so deposited, which shall be the amount permanently required

After said twenty-four months' period all of said reserves, except those herenbefore required to be held permanently in the Federal reserve bank, shall be held in its vaults or in the Federal reserve bank, or in both, at its option

(c) A bank in a central reserve city, as now or hereafter defined, shall hold and maintain a reserve equal to eighteen per centum of the aggregate amount of its demand liabilities and five per centum of its time deposits, as follows

In its vaults six-eighteenths thereof

In the Federal reserve bank for a period of six months after the date aforesaid at least three-eighteenths, and permanently thereafter six-eighteenths

The balance of said reserves shall be held in its own vaults or in the Federal reserve bank at its option

Any Federal reserve bank may receive from the member banks as reserves, not exceeding one-half of each installment, eligible paper as described in section fourteen properly indorsed and acceptable to the said reserve bank

If a State bank or trust company is required by the law of its State to keep its reserves either in its own vaults or with another State bank or trust company, such reserve deposits so kept in such State bank or trust company shall be construed, within the meaning of this section, as if they were reserve deposits in a national bank in a reserve or central reserve city for a period of three years after the Secretary of the Treasury shall have officially announced the establishment of a Federal reserve bank in the district in which such bank or trust company is situate Except as thus provided no member bank shall keep on deposit with any nonmember bank a sum in excess of ten per centum of its own paid-up capital and surplus No member bank shall act as the medium or agent of a nonmember bank in applying for or receiving discounts from a Federal reserve bank under the provisions of this Act

The reserve carried by a member bank with a Federal reserve bank

may, under the regulations and subject to such penalties as may be prescribed by the Federal Reserve Board, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities. Provided, however, That no bank shall at any time make new loans or shall pay any dividends unless and until the total reserve required by law is fully restored.

United States banks located in Alaska or outside the Continental United States may remain nonmember banks, and shall in that event maintain reserves and comply with all the conditions now provided by law regulating them, or said banks, except in the Philippine Islands, may, with the consent of the Reserve Board, become member banks of any one of the reserve districts, and shall, in that event, take stock, maintain reserves, and be subject to all the other provisions of this Act.

SEC 20 So much of sections two and three of the Act of June twentieth, eighteen hundred and seventy-four, entitled "An Act fixing the amount of United States notes, providing for a redistribution of the national-bank currency, and for other purposes," as provides that the fund deposited by any national banking association with the Treasurer of the United States for the redemption of its notes shall be counted as a part of its lawful reserve as provided in the Act aforesaid, be, and the same is hereby, repealed. And from and after the passage of this Act such fund of five per centum shall in no case be counted by any national banking association as a part of its lawful reserve.

BANK EXAMINATIONS

SEC 21 Every member bank shall be examined by the Comptroller of the Currency at least twice in each calendar year and as much oftener as the Federal Reserve Board shall consider necessary. The Federal Reserve Board may authorize examinations by the State authorities to be accepted in the case of State banks and trust companies and may at any time direct the holding of a special examination. The person making the examination of any member bank shall have power to call together a quorum of the directors of such bank, who shall, under oath state to such examiner the character and circumstances or such of its loans or discounts as he may designate. The Federal Reserve Board shall fix the salaries of all bank examiners and make report thereof to Congress. The expense of the examinations herein provided for shall be assessed by authority of the Federal Reserve Board upon the banks examined in proportion to assets or resources held by such banks upon the dates when the various banks are examined.

In addition to the examinations made and conducted by the Comptroller of the Currency, every Federal reserve bank may, with the approval of the Federal reserve agent or of the Federal Reserve Board, provide for special examinations of member banks within its district.

Such examinations shall be so conducted as to inform the Federal reserve bank under whose auspices it is carried on of the condition of its member banks and of the lines of credit which are being extended by them. Every Federal reserve bank shall at all times furnish to the Federal Reserve Board such information as may be demanded by the latter concerning the condition of any member bank within the district of the said Federal reserve bank.

No bank shall be subject to any visitatorial powers other than such as are authorized by law, or vested in the courts of justice, or such as shall be or shall have been exercised or directed by Congress, or either House thereof, or any committee thereof.

The Federal Reserve Board shall, at least once each year, order an examination of each Federal reserve bank, and upon joint application of ten member banks the Federal Reserve Board shall order a special examination and report of the condition of any Federal reserve bank.

SEC 22 No member bank or any officer, director, or employee thereof shall hereafter make any loan or grant any gratuity to any examiner of such bank. Any bank officer, director, or employee violating this provision shall be deemed guilty of a misdemeanor and shall be imprisoned not exceeding one year or fined not more than \$5,000, or both, and fined a further sum equal to the money so loaned or gratuity given. Any examiner accepting a loan or gratuity from any bank examined by him or from an officer, director, or employee thereof shall be deemed guilty of a misdemeanor and shall be imprisoned not exceeding one year or fined not more than \$5,000, or both, and fined a further sum equal to the money so loaned or gratuity given, and shall forever thereafter be disqualified from holding office as a national-bank examiner. No national-bank examiner shall perform any other service for compensation while holding such office for any bank or officer, director, or employee thereof.

Other than the usual salary or director's fee paid to any officer, director, or employee of a member bank and other than a reasonable fee paid by said bank to such officer, director, or employee for services rendered to such bank, no officer, director, employee, or attorney of a member bank shall be a beneficiary of or receive, directly or indirectly, any fee, commission, gift, or other consideration for or in connection with any transaction or business of the bank. No examiner, public or private, shall disclose the names of borrowers or the collateral for loans of a member bank to other than the proper officers of such bank without first having obtained the express permission in writing from the Comptroller of the Currency, or from the board of directors of such bank, except when ordered to do so by a court of competent jurisdiction, or by direction of the Congress of the United States, or either House thereof, or any committee thereof. Any person violating any provision of this

section shall be punished by a fine of not exceeding \$5,000 or by imprisonment not exceeding one year, or both

Except so far as already provided in existing laws this provision shall not take effect until sixty days after the passage of this Act

SEC 23 The stockholders of every national banking association shall be held individually responsible for all contracts, debts, and engagements of such association, each to the amount of his stock therein, at the par value thereof in addition to the amount invested in such stock. The stockholders in any national banking association who shall have transferred their shares or registered the transfer thereof within sixty days next before the date of the failure of such association to meet its obligations, or with knowledge of such impending failure, shall be liable to the same extent as if they had made no such transfer, to the extent that the subsequent transferee fails to meet such liability, but this provision shall not be construed to affect in any way any recourse which such shareholders might otherwise have against those in whose names such shares are registered at the time of such failure

LOANS ON FARM LANDS

SEC 24 Any national banking association not situated in a central reserve city may make loans secured by improved and unencumbered farm land, situated within its Federal reserve district, but no such loan shall be made for a longer time than five years, nor for an amount exceeding fifty per centum of the actual value of the property offered as security. Any such bank may make such loans in an aggregate sum equal to twenty-five per centum of its capital and surplus, or to one-third of its time deposits, and such banks may continue hereafter as heretofore to receive time deposits and to pay interest on the same

The Federal Reserve Board shall have power from time to time to add to the list of cities in which national banks shall not be permitted to make loans secured upon real estate in the manner described in this section

FOREIGN BRANCHES

SEC 25 Any national banking association possessing a capital and surplus of \$1,000,000 or more may file application with the Federal Reserve Board, upon such conditions and under such regulations as may be prescribed by the said board, for the purpose of securing authority to establish branches in foreign countries or dependencies of the United States for the furtherance of the foreign commerce of the United States and to act, if required to do so, as fiscal agents of the United States. Such application shall specify, in addition to the name and capital of the banking association filing it, the place or places where the banking operations proposed are to be carried on and the amount of capital set aside

by the said banking association filing such application for the conduct of its foreign business at the branches proposed by it to be established in such place or places. The Federal Reserve Board shall have power to approve or to reject such application if, in its judgment the amount of capital proposed to be set aside for the conduct of foreign business is inadequate or if for other reasons the granting of such application is deemed inexpedient.

Every national banking association which shall receive authority to establish foreign branches shall be required at all times to furnish information concerning the condition of such branches to the Comptroller of the Currency upon demand, and the Federal Reserve Board may order special examinations of the said foreign branches at such time or times as it may deem best. Every such national banking association shall conduct the accounts of each foreign branch independently of the accounts of other foreign branches established by it and of its home office, and shall at the end of each fiscal period transfer to its general ledger the profit or loss accruing at each branch as a separate item.

SEC 26 All provisions of law inconsistent with or superseded by any of the provisions of this Act are to that extent and to that extent only hereby repealed. Nothing in this Act contained shall be construed to repeal the parity provision or provisions contained in an Act approved March fourteenth, nineteen hundred, entitled "An Act to define and fix the standard of value, to maintain the parity of all forms of money issued or coined by the United States, to refund the public debt, and for other purposes," and the Secretary of the Treasury may for such purposes, or to strengthen the gold reserve, borrow gold on the security of United States bonds or for one-year notes bearing interest at a rate of not to exceed three per centum per annum, or sell the same if necessary to obtain gold. When the funds of the Treasury on hand justify, he may purchase and retire such outstanding bonds and notes.

SEC 27 The provisions of the Act of May thirtieth, nineteen hundred and eight, authorizing national currency associations, the issue of additional national-bank circulation, and creating a National Monetary Commission, which expires by limitation under the terms of such Act on the thirtieth day of June, nineteen hundred and fourteen, are hereby extended to June thirtieth, nineteen hundred and fifteen, and sections fifty-one hundred and fifty-three, fifty-one hundred and seventy-two, fifty-one hundred and ninety-one, and fifty-two hundred and fourteen of the Revised Statutes of the United States, which were amended by the Act of May twentieth, nineteen hundred and eight, are hereby reenacted to read as such sections read prior to May twentieth, nineteen hundred and eight, subject to such amendments or modifications as are prescribed in this Act. Provided, however, That section nine of said Act is hereby

amended so as to change so much of the tax rates fixed in said section by making the portion applicable thereto read as follows

"National banking associations having circulating notes secured otherwise than by bonds of the United States, shall pay for the first three months a tax at the rate of three per centum per annum upon the average amount of such of their notes in circulation as are based upon the deposit of such securities, and afterwards an additional tax rate of one-half of one per centum per annum for each month until a tax of six per centum per annum is reached, and thereafter such tax of six per centum per annum upon the average amount of such notes"

SEC 28 Section fifty-one hundred and forty-three of the Revised Statutes is hereby amended and reenacted to read as follows "Any association formed under this title may, by the vote of shareholders owning two-thirds of its capital stock, reduce its capital to any sum not below the amount required by this title to authorize the formation of associations, but no such reduction shall be allowable which will reduce the capital of the association below the amount required for its outstanding circulation, nor shall any reduction be made until the amount of the proposed reduction has been reported to the Comptroller of the Currency and such reduction has been approved by the said Comptroller of the Currency and by the Federal Reserve Board, or by the organization committee pending the organization of the Federal Reserve Board"

SEC 29 If any clause, sentence, paragraph, or part of this Act shall for any reason be adjudged by any court of competent jurisdiction to be invalid such judgment shall not affect impair or invalidate the remainder of this Act but shall be confined in its operation to the clause sentence, paragraph or part thereof directly involved in the controversy in which such judgment shall have been rendered

SEC 30 The right to amend alter, or repeal this Act is hereby expressly reserved

Resolved, That the Senate request a conference with the House or Representatives on the said bill and amendment

Ordered, That Mr Owen, Mr O'Gorman, Mr Reed, Mr Pomerene, Mr Shannon, Mr Hollis Mr Nelson Mr Bristow, and Mr Crawford be the conferees on the part of the Senate

Attest

Secretary

APPENDIX VI

THE FEDERAL RESERVE ACT

(As adopted)

An Act To provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the short title of this Act shall be the "Federal Reserve Act"

Wherever the word "bank" is used in this Act, the word shall be held to include State bank, banking association, and trust company, except where national banks or Federal reserve banks are specifically referred to

The terms "national bank" and "national banking association" used in this Act shall be held to be synonymous and interchangeable The term "member bank" shall be held to mean any national bank, State bank, or bank or trust company which has become a member of one of the reserve banks created by this Act The term "board" shall be held to mean Federal Reserve Board, the term "district" shall be held to mean Federal reserve district, the term "reserve bank" shall be held to mean Federal reserve bank

FEDERAL RESERVE DISTRICTS

SEC 2 As soon as practicable, the Secretary of the Treasury, the Secretary of Agriculture and the Comptroller of the Currency, acting as "The Reserve Bank Organization Committee," shall designate not less than eight nor more than twelve cities to be known as Federal reserve cities, and shall divide the continental United States, excluding Alaska, into districts, each district to contain only one of such Federal reserve cities The determination of said organization committee shall not be subject to review except by the Federal Reserve Board when organized *Provided*, That the districts shall be apportioned with due regard to the convenience and customary course of business and shall not necessarily be coterminous with any State or States The districts thus created may be readjusted and new districts may from time to time be created by the Federal Reserve Board, not to exceed twelve in all Such districts shall be known as Federal reserve districts and may be designated by number A majority of the organization committee shall constitute a quorum with authority to act

Said organization committee shall be authorized to employ counsel and expert aid, to take testimony, to send for persons and papers, to administer oaths, and to make such investigation as may be deemed necessary by the said committee in determining the reserve districts and in designating the cities within such districts where such Federal reserve banks shall be severally located. The said committee shall supervise the organization in each of the cities designated of a Federal reserve bank, which shall include in its title the name of the city in which it is situated, as "Federal Reserve Bank of Chicago."

Under regulations to be prescribed by the organization committee, every national banking association in the United States is hereby required, and every eligible bank in the United States and every trust company within the District of Columbia, is hereby authorized to signify in writing, within sixty days after the passage of this Act, its acceptance of the terms and provisions hereof. When the organization committee shall have designated the cities in which Federal reserve banks are to be organized, and fixed the geographical limits of the Federal reserve districts, every national banking association within that district shall be required within thirty days after notice from the organization committee, to subscribe to the capital stock of such Federal reserve bank in a sum equal to six per centum of the paid-up capital stock and surplus of such bank, one-sixth of the subscription to be payable on call of the organization committee or of the Federal Reserve Board one-sixth within three months and one-sixth within six months thereafter, and the remainder of the subscription or any part thereof, shall be subject to call when deemed necessary by the Federal Reserve Board, said payments to be in gold or gold certificates.

The shareholders of every Federal reserve bank shall be held individually responsible, equally and ratably and not one for another, for all contracts, debts and engagements of such bank to the extent of the amount of their subscriptions to such stock at the par value thereof in addition to the amount subscribed, whether such subscriptions have been paid up in whole or in part, under the provisions of this Act.

Any national bank failing to signify its acceptance of the terms of this Act within the sixty days aforesaid, shall cease to act as a reserve agent, upon thirty days' notice, to be given within the discretion of the said organization committee or of the Federal Reserve Board.

Should any national banking association in the United States now organized fail within one year after the passage of this Act to become a member bank or fail to comply with any of the provisions of this Act applicable thereto, all of the rights, privileges, and franchises of such association granted to it under the national-bank Act, or under the provisions of this Act shall be thereby forfeited. Any noncompliance with or violation of this Act shall, however, be determined and adjudged by any court of the United States of competent jurisdiction in a suit brought for that

purpose in the district or territory in which such bank is located, under direction of the Federal Reserve Board, by the Comptroller of the Currency in his own name before the association shall be declared dissolved. In cases of such noncompliance or violation, other than the failure to become a member bank under the provisions of this Act, every director who participated in or assented to the same shall be held liable in his personal or individual capacity for all damages which said bank, its shareholders, or any other person shall have sustained in consequence of such violation.

Such dissolution shall not take away or impair any remedy against such corporation, its stockholders or officers, for any liability or penalty which shall have been previously incurred.

Should the subscriptions by banks to the stock of said Federal reserve banks or any one or more of them be, in the judgment of the organization committee, insufficient to provide the amount of capital required therefor, then and in that event the said organization committee may, under conditions and regulations to be prescribed by it, offer to public subscription at par such an amount of stock in said Federal reserve banks, or any one or more of them, as said committee shall determine, subject to the same conditions as to payment and stock liability as provided for member banks.

No individual, copartnership, or corporation other than a member bank of its district shall be permitted to subscribe for or to hold at any time more than \$25,000 par value of stock in any Federal reserve bank. Such stock shall be known as public stock and may be transferred on the books of the Federal reserve bank by the chairman of the board of directors of such bank.

Should the total subscriptions by banks and the public to the stock of said Federal reserve banks, or any one or more of them, be, in the judgment of the organization committee, insufficient to provide the amount of capital required therefor, then and in that event the said organization committee shall allot to the United States such an amount of said stock as said committee shall determine. Said United States stock shall be paid for at par out of any money in the Treasury not otherwise appropriated, and shall be held by the Secretary of the Treasury and disposed of for the benefit of the United States in such manner, at such times, and at such price, not less than par, as the Secretary of the Treasury shall determine.

Stock not held by member banks shall not be entitled to voting power.

The Federal Reserve Board is hereby empowered to adopt and promulgate rules and regulations governing the transfers of said stock.

No Federal reserve bank shall commence business with a subscribed capital less than \$4,000,000. The organization of reserve districts and Federal reserve cities shall not be construed as changing the present status of reserve cities and central reserve cities, except in so far as this Act changes the amount of reserves that may be carried with approved reserve agents located therein. The organization committee shall have power to appoint

such assistants and incur such expenses in carrying out the provisions of this Act as it shall deem necessary, and such expenses shall be payable by the Treasurer of the United States upon voucher approved by the Secretary of the Treasury, and the sum of \$100,000, or so much thereof as may be necessary, is hereby appropriated, out of any moneys in the Treasury not otherwise appropriated, for the payment of such expenses

BRANCH OFFICES

SEC 3 Each Federal reserve bank shall establish branch banks within the Federal reserve district in which it is located and may do so in the district of any Federal reserve bank which may have been suspended. Such branches shall be operated by a board of directors under rules and regulations approved by the Federal Reserve Board. Directors of branch banks shall possess the same qualifications as directors of the Federal reserve banks. Four of said directors shall be selected by the reserve bank and three by the Federal Reserve Board, and they shall hold office during the pleasure, respectively, of the parent bank and the Federal Reserve Board. The reserve bank shall designate one of the directors as manager.

FEDERAL RESERVE BANKS

SEC 4 When the organization committee shall have established Federal reserve districts as provided in section two of this Act, a certificate shall be filed with the Comptroller of the Currency showing the geographical limits of such districts and the Federal reserve city designated in each of such districts. The Comptroller of the Currency shall thereupon cause to be forwarded to each national bank located in each district, and to such other banks declared to be eligible by the organization committee which may apply therefor, an application blank in form to be approved by the organization committee, which blank shall contain a resolution to be adopted by the board of directors of each bank executing such application, authorizing a subscription to the capital stock of the Federal reserve bank organizing in that district in accordance with the provisions of this Act.

When the minimum amount of capital stock prescribed by this Act for the organization of any Federal reserve bank shall have been subscribed and allotted, the organization committee shall designate any five banks of those whose applications have been received, to execute a certificate of organization, and thereupon the banks so designated shall, under their seals, make an organization certificate which shall specifically state the name of such Federal reserve bank, the territorial extent of the district over which the operations of such Federal reserve bank are to be carried on, the city and State in which said bank is to be located, the amount of capital stock and the number of shares into which the same is divided, the name and place of doing business of each bank executing such certificate, and of all

banks which have subscribed to the capital stock of such Federal reserve bank and the number of shares subscribed by each, and the fact that the certificate is made to enable those banks executing same, and all banks which have subscribed or may thereafter subscribe to the capital stock of such Federal reserve bank, to avail themselves of the advantages of this Act

The said organization certificate shall be acknowledged before a judge of some court of record or notary public, and shall be, together with the acknowledgment thereof, authenticated by the seal of such court, or notary, transmitted to the Comptroller of the Currency, who shall file, record and carefully preserve the same in his office

Upon the filing of such certificate with the Comptroller of the Currency as aforesaid, the said Federal reserve bank shall become a body corporate and as such, and in the name designated in such organization certificate, shall have power—

First To adopt and use a corporate seal

Second To have succession for a period of twenty years from its organization unless it is sooner dissolved by an Act of Congress, or unless its franchise becomes forfeited by some violation of law

Third To make contracts

Fourth To sue and be sued, complain and defend, in any court of law or equity

Fifth To appoint by its board of directors, such officers and employees as are not otherwise provided for in this Act, to define their duties, require bonds of them and fix the penalty thereof, and to dismiss at pleasure such officers or employees

Sixth To prescribe by its board of directors, by-laws not inconsistent with law, regulating the manner in which its general business may be conducted, and the privileges granted to it by law may be exercised and enjoyed

Seventh To exercise by its board of directors, or duly authorized officers or agents, all powers specifically granted by the provisions of this Act and such incidental powers as shall be necessary to carry on the business of banking within the limitations prescribed by this Act

Eighth Upon deposit with the Treasurer of the United States of any bonds of the United States in the manner provided by existing law relating to national banks, to receive from the Comptroller of the Currency circulating notes in blank, registered and countersigned as provided by law, equal in amount to the par value of the bonds so deposited, such notes to be issued under the same conditions and provisions of law as relate to the issue of circulating notes of national banks secured by bonds of the United States bearing the circulating privilege, except that the issue of such notes shall not be limited to the capital stock of such Federal reserve bank

But no Federal reserve bank shall transact any business except such as is incidental and necessarily preliminary to its organization until it has

been authorized by the Comptroller of the Currency to commence business under the provisions of this Act

Every Federal reserve bank shall be conducted under the supervision and control of a board of directors

The board of directors shall perform the duties usually appertaining to the office of directors of banking associations and all such duties as are prescribed by law

Said board shall administer the affairs of said bank fairly and impartially and without discrimination in favor of or against any member bank or banks and shall, subject to the provisions of law and the orders of the Federal Reserve Board, extend to each member bank such discounts, advancements and accommodations as may be safely and reasonably made with due regard for the claims and demands of other member banks

Such board of directors shall be selected as hereinafter specified and shall consist of nine members, holding office for three years, and divided into three classes, designated as classes A, B, and C

Class A shall consist of three members, who shall be chosen by and be representative of the stock-holding banks

Class B shall consist of three members, who at the time of their election shall be actively engaged in their district in commerce, agriculture or some other industrial pursuit

Class C shall consist of three members who shall be designated by the Federal Reserve Board When the necessary subscriptions to the capital stock have been obtained for the organization of any Federal reserve bank, the Federal Reserve Board shall appoint the class C directors and shall designate one of such directors as chairman of the board to be selected Pending the designation of such chairman, the organization committee shall exercise the powers and duties appertaining to the office of chairman in the organization of such Federal reserve bank

No Senator or Representative in Congress shall be a member of the Federal Reserve Board or an officer or a director of a Federal reserve bank

No director of class B shall be an officer, director or employee of any bank

No director of class C shall be an officer, director, employee, or stockholder of any bank

Directors of class A and class B shall be chosen in the following manner

The chairman of the board of directors of the Federal reserve bank of the district in which the bank is situated or pending the appointment of such chairman, the organization committee shall classify the member banks of the district into three general groups or divisions Each group shall contain as nearly as may be one-third of the aggregate number of the member banks of the district and shall consist, as nearly as may be, of

banks of similar capitalization The groups shall be designated by number by the chairman

At a regularly called meeting of the board of directors of each member bank in the district it shall elect by ballot a district reserve elector and shall certify his name to the chairman of the board of directors of the Federal reserve bank of the district The chairman shall make lists of the district reserve electors thus named by banks in each of the aforesaid three groups and shall transmit one list to each elector in each group

Each member bank shall be permitted to nominate to the chairman one candidate for director of class A and one candidate for director of class B The candidates so nominated shall be listed by the chairman, indicating by whom nominated, and a copy of said list shall, within fifteen days after its completion, be furnished by the chairman to each elector

Every elector shall, within fifteen days after the receipt of the said list, certify to the chairman his first, second, and other choices of a director of class A and class B, respectively, upon a preferential ballot, on a form furnished by the chairman of the board of directors of the Federal reserve bank of the district Each elector shall make a cross opposite the name of the first, second, and other choices for a director of class A and for a director of class B, but shall not vote more than one choice for any one candidate

Any candidate having a majority of all votes cast in the column of first choice shall be declared elected If no candidate have a majority of all the votes in the first column, then there shall be added together the votes cast by the electors for such candidates in the second column and the votes cast for the several candidates in the first column If any candidate then have a majority of the electors voting, by adding together the first and second choices, he shall be declared elected If no candidate have a majority of electors voting when the first and second choices shall have been added, then the votes cast in the third column for other choices shall be added together in like manner, and the candidate then having the highest number of votes shall be declared elected An immediate report of election shall be declared

Class C directors shall be appointed by the Federal Reserve Board They shall have been for at least two years residents of the district for which they are appointed, one of whom shall be designated by said board as chairman of the board of directors of the Federal reserve bank and as "Federal reserve agent" He shall be a person of tested banking experience, and in addition to his duties as chairman of the board of directors of the Federal reserve bank he shall be required to maintain under regulations to be established by the Federal Reserve Board a local office of said board on the premises of the Federal reserve bank He shall make regular reports to the Federal Reserve Board, and shall act as its official representative for the performance of the functions conferred upon it by this

Act He shall receive an annual compensation to be fixed by the Federal Reserve Board and paid monthly by the Federal reserve bank to which he is designated One of the directors of class C, who shall be a person of tested banking experience, shall be appointed by the Federal Reserve Board as deputy chairman and deputy Federal reserve agent to exercise the powers of the chairman of the board and Federal reserve agent in case of absence or disability of his principal

Directors of Federal reserve banks shall receive, in addition to any compensation otherwise provided, a reasonable allowance for necessary expenses in attending meetings of their respective boards, which amount shall be paid by the respective Federal reserve banks Any compensation that may be provided by boards of directors of Federal reserve banks for directors, officers or employees shall be subject to the approval of the Federal Reserve Board

The Reserve Bank Organization Committee may, in organizing Federal reserve banks, call such meetings of bank directors in the several districts as may be necessary to carry out the purposes of this Act, and may exercise the functions herein conferred upon the chairman of the board of directors of each Federal reserve bank pending the complete organization of such bank

At the first meeting of the full board of directors of each Federal reserve bank, it shall be the duty of the directors of classes A, B and C, respectively, to designate one of the members of each class whose term of office shall expire in one year from the first of January nearest to date of such meeting, one whose term of office shall expire at the end of two years from said date, and one whose term of office shall expire at the end of three years from said date Thereafter every director of a Federal reserve bank chosen as hereinbefore provided shall hold office for a term of three years Vacancies that may occur in the several classes of directors of Federal reserve banks may be filled in the manner provided for the original selection of such directors such appointees to hold office for the unexpired terms of their predecessors

STOCK ISSUES, INCREASE AND DECREASE OF CAPITAL

SEC 5 The capital stock of each Federal reserve bank shall be divided into shares of \$100 each The outstanding capital stock shall be increased from time to time as member banks increase their capital stock and surplus or as additional banks become members and may be decreased as member banks reduce their capital stock or surplus or cease to be members Shares of the capital stock of Federal reserve banks owned by member banks shall not be transferred or hypothecated When a member bank increases its capital stock or surplus, it shall thereupon subscribe for an additional amount of capital stock of the Federal reserve bank of its district equal to six per centum of the said increase, one-half of said subscription to be paid

in the manner heretofore provided for original subscription, and one-half subject to call of the Federal Reserve Board. A bank applying for stock in a Federal reserve bank at any time after the organization thereof must subscribe for an amount of the capital stock of the Federal reserve bank equal to six per centum of the paid-up capital stock and surplus of said applicant bank, paying therefor its par value plus one-half of one per centum a month from the period of the last dividend. When the capital stock of any Federal reserve bank shall have been increased either on account of the increase of capital stock of member banks or on account of the increase in the number of member banks, the board of directors shall cause to be executed a certificate to the Comptroller of the Currency showing the increase in capital stock, the amount paid in, and by whom paid. When a member bank reduces its capital stock it shall surrender a proportionate amount of its holdings in the capital of said Federal reserve bank, and when a member bank voluntarily liquidates it shall surrender all of its holdings of the capital stock of said Federal reserve bank and be released from its stock subscription not previously called. In either case the shares surrendered shall be canceled and the member bank shall receive in payment therefor, under regulations to be prescribed by the Federal Reserve Board, a sum equal to its cash-paid subscriptions on the shares surrendered and one-half of one per centum a month from the period of the last dividend, not to exceed the book value thereof, less any liability of such member bank to the Federal reserve bank.

SEC 6 If any member bank shall be declared insolvent and a receiver appointed therefor, the stock held by it in said Federal reserve bank shall be canceled, without impairment of its liability, and all cash-paid subscriptions on said stock, with one-half of one per centum per month from the period of last dividend, not to exceed the book value thereof, shall be first applied to all debts of the insolvent member bank to the Federal reserve bank, and the balance, if any, shall be paid to the receiver of the insolvent bank. Whenever the capital stock of a Federal reserve bank is reduced, either on account of a reduction in capital stock of any member bank or of the liquidation or insolvency of such bank, the board of directors shall cause to be executed a certificate to the Comptroller of the Currency showing such reduction of capital stock and the amount repaid to such bank.

DIVISION OF EARNINGS

SEC 7 After all necessary expenses of a Federal reserve bank have been paid or provided for, the stockholders shall be entitled to receive an annual dividend of six per centum on the paid-in capital stock, which dividend shall be cumulative. After the aforesaid dividend claims have been fully met, all the net earnings shall be paid to the United States as a franchise tax, except that one-half of such net earnings shall be paid into a

surplus fund until it shall amount to forty per centum of the paid-in capital stock of such bank

The net earnings derived by the United States from Federal reserve banks shall, in the discretion of the Secretary, be used to supplement the gold reserve held against outstanding United States notes, or shall be applied to the reduction of the outstanding bonded indebtedness of the United States under regulations to be prescribed by the Secretary of the Treasury. Should a Federal reserve bank be dissolved or go into liquidation, any surplus remaining, after the payment of all debts, dividend requirements as hereinbefore provided, and the par value of the stock, shall be paid to and become the property of the United States and shall be similarly applied.

Federal reserve banks, including the capital stock and surplus therein, and the income derived therefrom shall be exempt from Federal, State, and local taxation, except taxes upon real estate.

SEC 8 Section fifty-one hundred and fifty-four, United States Revised Statutes, is hereby amended to read as follows:

Any bank incorporated by special law of any State or of the United States or organized under the general laws of any State or of the United States and having an unimpaired capital sufficient to entitle it to become a national banking association under the provisions of the existing laws may by the vote of the shareholders owning not less than fifty-one per centum of the capital stock of such bank or banking association with the approval of the Comptroller of the Currency be converted into a national banking association, with any name approved by the Comptroller of the Currency.

Provided, however, That said conversion shall not be in contravention of the State law. In such case the articles of association and organization certificate may be executed by a majority of the directors of the bank or banking institution, and the certificate shall declare that the owners of fifty-one per centum of the capital stock have authorized the directors to make such certificate and to change or convert the bank or banking institution into a national association. A majority of the directors, after executing the articles of association and the organization certificate shall have power to execute all other papers and to do whatever may be required to make its organization perfect and complete as a national association. The shares of any such bank may continue to be for the same amount each as they were before the conversion, and the directors may continue to be directors of the association until others are elected or appointed in accordance with the provisions of the statutes of the United States. When the comptroller has given to such bank or banking association a certificate that the provisions of this Act have been complied with such bank or banking association, and all its stockholders, officers, and employees shall have the same powers and privileges, and shall be subject to the same duties, liabilities, and regulations, in all respects, as shall have been prescribed by the Federal Reserve

Act and by the national banking Act for associations originally organized as national banking associations

STATE BANKS AS MEMBERS

SEC 9 Any bank incorporated by special law of any State, or organized under the general laws of any State or of the United States, may make application to the reserve bank organization committee, pending organization, and thereafter to the Federal Reserve Board for the right to subscribe to the stock of the Federal reserve bank organized or to be organized within the Federal reserve district where the applicant is located. The organization committee or the Federal Reserve Board, under such rules and regulations as it may prescribe, subject to the provisions of this section, may permit the applying bank to become a stockholder in the Federal reserve bank of the district in which the applying bank is located. Whenever the organization committee or the Federal Reserve Board shall permit the applying bank to become a stockholder in the Federal reserve bank of the district, stock shall be issued and paid for under the rules and regulations in this Act provided for national banks which become stockholders in Federal reserve banks.

The organization committee or the Federal Reserve Board shall establish by-laws for the general government of its conduct in acting upon applications made by the State banks and banking associations and trust companies for stock ownership in Federal reserve banks. Such by-laws shall require applying banks not organized under Federal law to comply with the reserve and capital requirements and to submit to the examination and regulations prescribed by the organization committee or by the Federal Reserve Board. No applying bank shall be admitted to membership in a Federal reserve bank unless it possesses a paid-up unimpaired capital sufficient to entitle it to become a national banking association in the place where it is situated, under the provisions of the national banking Act.

Any bank becoming a member of a Federal reserve bank under the provisions of this section shall, in addition to the regulations and restrictions hereinbefore provided, be required to conform to the provisions of law imposed on the national banks respecting the limitation of liability which may be incurred by any person, firm, or corporation to such banks, the prohibition against making purchase of or loans on stock of such banks, and the withdrawal or impairment of capital, or the payment of unearned dividends, and to such rules and regulations as the Federal Reserve Board may, in pursuance thereof, prescribe.

Such banks, and the officers, agents, and employees thereof, shall also be subject to the provisions of and to the penalties prescribed by sections fifty-one hundred and ninety-eight, fifty-two hundred, fifty-two hundred and one, and fifty-two hundred and eight, and fifty-two hundred and nine of the Revised Statutes. The member banks shall also be required to make

reports of the conditions and of the payments of dividends to the comptroller, as provided in sections fifty-two hundred and eleven and fifty-two hundred and twelve of the Revised Statutes, and shall be subject to the penalties prescribed by section fifty-two hundred and thirteen for the failure to make such report

If at any time it shall appear to the Federal Reserve Board that a member bank has failed to comply with the provisions of this section or the regulations of the Federal Reserve Board, it shall be within the power of the said board, after hearing, to require such bank to surrender its stock in the Federal reserve bank, upon such surrender the Federal reserve bank shall pay the cash-paid subscriptions to the said stock with interest at the rate of one-half of one per centum per month, computed from the last dividend, if earned, not to exceed the book value thereof, less any liability to said Federal reserve bank, except the subscription liability not previously called, which shall be canceled, and said Federal reserve bank shall, upon notice from the Federal Reserve Board, be required to suspend said bank from further privileges of membership, and shall within thirty days of such notice cancel and retire its stock and make payment therefor in the manner herein provided. The Federal Reserve Board may restore membership upon due proof of compliance with the conditions imposed by this section

FEDERAL RESERVE BOARD

SEC 10 A Federal Reserve Board is hereby created which shall consist of seven members, including the Secretary of the Treasury and the Comptroller of the Currency, who shall be members ex officio, and five members appointed by the President of the United States, by and with the advice and consent of the Senate. In selecting the five appointive members of the Federal Reserve Board, not more than one of whom shall be selected from any one Federal reserve district, the President shall have due regard to a fair representation of the different commercial, industrial and geographical divisions of the country. The five members of the Federal Reserve Board appointed by the President and confirmed as aforesaid shall devote their entire time to the business of the Federal Reserve Board and shall each receive an annual salary of \$12,000, payable monthly together with actual necessary traveling expenses, and the Comptroller of the Currency, as ex officio member of the Federal Reserve Board shall in addition to the salary now paid him as Comptroller of the Currency, receive the sum of \$7,000 annually for his services as a member of said Board.

The members of said board, the Secretary of the Treasury, the Assistant Secretaries of the Treasury, and the Comptroller of the Currency shall be ineligible during the time they are in office and for two years thereafter to hold any office position, or employment in any member bank. Of the five members thus appointed by the President at least two shall be persons experienced in banking or finance. One shall be designated by the Presi-

dent to serve for two, one for four, one for six, one for eight, and one for ten years, and thereafter each member so appointed shall serve for a term of ten years unless sooner removed for cause by the President. Of the five persons thus appointed, one shall be designated by the President as governor and one as vice governor of the Federal Reserve Board. The governor of the Federal Reserve Board, subject to its supervision, shall be the active executive officer. The Secretary of the Treasury may assign offices in the Department of the Treasury for the use of the Federal Reserve Board. Each member of the Federal Reserve Board shall within fifteen days after notice of appointment make and subscribe to the oath of office.

The Federal Reserve Board shall have power to levy semiannually upon the Federal reserve banks, in proportion to their capital stock and surplus, an assessment sufficient to pay its estimated expenses and the salaries of its members and employees for the half year succeeding the levying of such assessment, together with any deficit carried forward from the preceding half year.

The first meeting of the Federal Reserve Board shall be held in Washington, District of Columbia, as soon as may be after the passage of this Act, at a date to be fixed by the Reserve Bank Organization Committee. The Secretary of the Treasury shall be ex officio chairman of the Federal Reserve Board. No member of the Federal Reserve Board shall be an officer or director of any bank, banking institution, trust company, or Federal reserve bank nor hold stock in any bank, banking institution, or trust company, and before entering upon his duties as a member of the Federal Reserve Board he shall certify under oath to the Secretary of the Treasury that he has complied with this requirement. Whenever a vacancy shall occur, other than by expiration of term, among the five members of the Federal Reserve Board appointed by the President, as above provided, a successor shall be appointed by the President, with the advice and consent of the Senate, to fill such vacancy, and when appointed he shall hold office for the unexpired term of the member whose place he is selected to fill.

The President shall have power to fill all vacancies that may happen on the Federal Reserve Board during the recess of the Senate, by granting commissions which shall expire thirty days after the next session of the Senate convenes.

Nothing in this Act contained shall be construed as taking away any powers heretofore vested by law in the Secretary of the Treasury which relate to the supervision, management, and control of the Treasury Department and bureaus under such department, and wherever any power vested by this Act in the Federal Reserve Board or the Federal reserve agent appears to conflict with the powers of the Secretary of the Treasury, such powers shall be exercised subject to the supervision and control of the Secretary.

The Federal Reserve Board shall annually make a full report of its operations to the Speaker of the House of Representatives, who shall cause the same to be printed for the information of the Congress

Section three hundred and twenty-four of the Revised Statutes of the United States shall be amended so as to read as follows There shall be in the Department of the Treasury a bureau charged with the execution of all laws passed by Congress relating to the issue and regulation of national currency secured by United States bonds and, under the general supervision of the Federal Reserve Board, of all Federal reserve notes, the chief officer of which bureau shall be called the Comptroller of the Currency and shall perform his duties under the general directions of the Secretary of the Treasury

SIC 11 The Federal Reserve Board shall be authorized and empowered

(a) To examine at its discretion the accounts, books and affairs of each Federal reserve bank and of each member bank and to require such statements and reports as it may deem necessary The said board shall publish once each week a statement showing the condition of each Federal reserve bank and a consolidated statement for all Federal reserve banks Such statements shall show in detail the assets and liabilities of the Federal reserve banks, single and combined, and shall furnish full information regarding the character of the money held as reserve and the amount, nature and maturities of the paper and other investments owned or held by Federal reserve banks

(b) To permit, on the affirmative vote of at least five members of the Reserve Board to require Federal reserve banks to rediscount the discounted paper of other Federal reserve banks at rates of interest to be fixed by the Federal Reserve Board

(c) To suspend for a period not exceeding thirty days, and from time to time to renew such suspension for periods not exceeding fifteen days, any reserve requirement specified in this Act *Provided*, That it shall establish a graduated tax upon the amounts by which the reserve requirements of this Act may be permitted to fall below the level hereinafter specified *And provided further*, That when the gold reserve held against Federal reserve notes falls below forty per centum, the Federal Reserve Board shall establish a graduated tax of not more than one per centum per annum upon such deficiency until the reserves fall to thirty-two and one-half per centum and when said reserve falls below thirty-two and one-half per centum, a tax at the rate increasingly of not less than one and one-half per centum per annum upon each two and one-half per centum or fraction thereof that such reserve falls below thirty-two and one-half per centum The tax shall be paid by the reserve bank, but the reserve bank shall add an amount equal to said tax to the rates of interest and discount fixed by the Federal Reserve Board

(d) To supervise and regulate through the bureau under the charge of

the Comptroller of the Currency the issue and retirement of Federal reserve notes, and to prescribe rules and regulations under which such notes may be delivered by the Comptroller to the Federal reserve agents applying therefor

(e) To add to the number of cities classified as reserve and central reserve cities under existing law in which national banking associations are subject to the reserve requirements set forth in section twenty of this Act, or to reclassify existing reserve and central reserve cities or to terminate their designation as such

(f) To suspend or remove any officer or director of any Federal reserve bank, the cause of such removal to be forthwith communicated in writing by the Federal Reserve Board to the removed officer or director and to said bank

(g) To require the writing off of doubtful or worthless assets upon the books and balance sheets of Federal reserve banks

(h) To suspend, for the violation of any of the provisions of this Act, the operations of any Federal reserve bank, to take possession thereof, administer the same during the period of suspension, and, when deemed advisable, to liquidate or reorganize such bank

(i) To require bonds of Federal reserve agents, to make regulations for the safeguarding of all collateral, bonds, Federal reserve notes, money or property of any kind deposited in the hands of such agents, and said board shall perform the duties, functions, or services specified in this Act, and make all rules and regulations necessary to enable said board effectively to perform the same

(j) To exercise general supervision over said Federal reserve banks

(k) To grant by special permit to national banks applying therefor, when not in contravention of State or local law, the right to act as trustee, executor, administrator, or registrar of stocks and bonds under such rules and regulations as the said board may prescribe

(l) To employ such attorneys, experts, assistants, clerks, or other employees as may be deemed necessary to conduct the business of the board. All salaries and fees shall be fixed in advance by said board and shall be paid in the same manner as the salaries of the members of said board. All such attorneys, experts, assistants, clerks, and other employees shall be appointed without regard to the provisions of the Act of January sixteenth, eighteen hundred and eighty-three (volume twenty-two, United States Statutes at Large, page four hundred and three), and amendments thereto, or any rule or regulation made in pursuance thereof. *Provided*, That nothing herein shall prevent the President from placing said employees in the classified service

FEDERAL ADVISORY COUNCIL

SEC. 12 There is hereby created a Federal Advisory Council, which shall consist of as many members as there are Federal reserve districts. Each

Federal reserve bank by its board of directors shall annually select from its own Federal reserve district one member of said council, who shall receive such compensation and allowances as may be fixed by his board of directors subject to the approval of the Federal Reserve Board. The meetings of said advisory council shall be held at Washington, District of Columbia, at least four times each year, and oftener if called by the Federal Reserve Board. The council may in addition to the meetings above provided for hold such other meetings in Washington, District of Columbia, or elsewhere, as it may deem necessary, may select its own officers and adopt its own methods of procedure, and a majority of its members shall constitute a quorum for the transaction of business. Vacancies in the council shall be filled by the respective reserve banks, and members selected to fill vacancies, shall serve for the unexpired term.

The Federal Advisory Council shall have power, by itself or through its officers, (1) to confer directly with the Federal Reserve Board on general business conditions, (2) to make oral or written representations concerning matters within the jurisdiction of said board, (3) to call for information and to make recommendations in regard to discount rates, rediscount business, note issues, reserve conditions in the various districts, the purchase and sale of gold or securities by reserve banks, open-market operations by said banks, and the general affairs of the reserve banking system.

POWERS OF FEDERAL RESERVE BANKS

SEC 13 Any Federal reserve bank may receive from any of its member banks, and from the United States, deposits of current funds in lawful money, national-bank notes, Federal reserve notes, or checks and drafts upon solvent member banks, payable upon presentation, or, solely for exchange purposes, may receive from other Federal reserve banks deposits of current funds in lawful money, national-bank notes, or checks and drafts upon solvent member or other Federal reserve banks, payable upon presentation.

Upon the indorsement of any of its member banks, with a waiver of demand, notice and protest by such bank, any Federal reserve bank may discount notes, drafts, and bills of exchange arising out of actual commercial transactions, that is notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes, the Federal Reserve Board to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this Act. Nothing in this Act contained shall be construed to prohibit such notes, drafts, and bills of exchange, secured by staple agricultural products, or other goods, wares, or merchandise from being eligible for such discount, but such definition shall not include notes, drafts, or bills covering merely investments

or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States. Notes, drafts, and bills admitted to discount under the terms of this paragraph must have a maturity at the time of discount of not more than ninety days. *Provided*, That notes, drafts, and bills drawn or issued for agricultural purposes or based on live stock and having a maturity not exceeding six months may be discounted in an amount to be limited to a percentage of the capital of the Federal reserve bank, to be ascertained and fixed by the Federal Reserve Board.

Any Federal reserve bank may discount acceptances which are based on the importation or exportation of goods and which have a maturity at time of discount of not more than three months, and indorsed by at least one member bank. The amount of acceptances so discounted shall at no time exceed one-half the paid-up capital stock and surplus of the bank for which the rediscounts are made.

The aggregate of such notes and bills bearing the signature or indorsement of any one person, company, firm, or corporation rediscounted for any one bank shall at no time exceed ten per centum of the unimpaired capital and surplus of said bank, but this restriction shall not apply to the discount of bills of exchange drawn in good faith against actually existing values.

Any member bank may accept drafts or bills of exchange drawn upon it and growing out of transactions involving the importation or exportation of goods having not more than six months sight to run, but no bank shall accept such bills to an amount equal at any time in the aggregate to more than one-half its paid-up capital stock and surplus.

Section fifty-two hundred and two of the Revised Statutes of the United States is hereby amended so as to read as follows: No national banking association shall at any time be indebted, or in any way liable, to an amount exceeding the amount of its capital stock at such time actually paid in and remaining undiminished by losses or otherwise, except on account of demands of the nature following:

First. Notes of circulation.

Second. Moneys deposited with or collected by the association.

Third. Bills of exchange or drafts drawn against money actually on deposit to the credit of the association, or due thereto.

Fourth. Liabilities to the stockholders of the association for dividends and reserve profits.

Fifth. Liabilities incurred under the provisions of the Federal Reserve Act.

The rediscount by any Federal reserve bank of any bills receivable and of domestic and foreign bills of exchange, and of acceptances authorized by this Act, shall be subject to such restrictions, limitations, and regulations as may be imposed by the Federal Reserve Board.

OPEN-MARKET OPERATIONS

SEC 14 Any Federal reserve bank may, under rules and regulations prescribed by the Federal Reserve Board, purchase and sell in the open market, at home or abroad, either from or to domestic or foreign banks, firms, corporations, or individuals, cable transfers and bankers' acceptances and bills of exchange of the kinds and maturities by this Act made eligible for rediscount, with or without the indorsement of a member bank

Every Federal reserve bank shall have power

(a) To deal in gold coin and bullion at home or abroad, to make loans thereon, exchange Federal reserve notes for gold, gold coin, or gold certificates, and to contract for loans of gold coin or bullion, giving therefor, when necessary, acceptable security, including the hypothecation of United States bonds or other securities which Federal reserve banks are authorized to hold,

(b) To buy and sell, at home or abroad, bonds and notes of the United States and bills notes revenue bonds, and warrants with a maturity from date of purchase of not exceeding six months, issued in anticipation of the collection of taxes or in anticipation of the receipt of assured revenues by any State, county, district, political subdivision, or municipality in the continental United States, including irrigation, drainage and reclamation districts such purchases to be made in accordance with rules and regulations prescribed by the Federal Reserve Board,

(c) To purchase from member banks and to sell, with or without its indorsement, bills of exchange arising out of commercial transactions, as heretofore defined,

(d) To establish from time to time, subject to review and determination of the Federal Reserve Board, rates of discount to be charged by the Federal reserve bank for each class of paper, which shall be fixed with a view of accommodating commerce and business,

(e) To establish accounts with other Federal reserve banks for exchange purposes and, with the consent of the Federal Reserve Board, to open and maintain banking accounts in foreign countries, appoint correspondents, and establish agencies in such countries wheresoever it may deem best for the purpose of purchasing, selling and collecting bills of exchange, and to buy and sell with or without its indorsement, through such correspondents or agencies bills of exchange arising out of actual commercial transactions which have not more than ninety days to run and which bear the signature of two or more responsible parties

GOVERNMENT DEPOSITS

SEC 15 The moneys held in the general fund of the Treasury, except the five per centum fund for the redemption of outstanding national-bank notes and the funds provided in this Act for the redemption of Federal

reserve notes may, upon the direction of the Secretary of the Treasury, be deposited in Federal reserve banks, which banks, when required by the Secretary of the Treasury, shall act as fiscal agents of the United States, and the revenues of the Government or any part thereof may be deposited in such banks, and disbursements may be made by checks drawn against such deposits

No public funds of the Philippine Islands, or of the postal savings, or any Government funds, shall be deposited in the continental United States in any bank not belonging to the system established by this Act *Provided, however,* That nothing in this Act shall be construed to deny the right of the Secretary of the Treasury to use member banks as depositories

NOTE ISSUES

SEC 16 Federal reserve notes, to be issued at the discretion of the Federal Reserve Board for the purpose of making advances to Federal reserve banks through the Federal reserve agents as hereinafter set forth and for no other purpose, are hereby authorized. The said notes shall be obligations of the United States and shall be receivable by all national and member banks and Federal reserve banks and for all taxes, customs, and other public dues. They shall be redeemed in gold on demand at the Treasury Department of the United States, in the city of Washington, District of Columbia, or in gold or lawful money at any Federal reserve bank.

Any Federal reserve bank may make application to the local Federal reserve agent for such amount of the Federal reserve notes hereinbefore provided for as it may require. Such application shall be accompanied with a tender to the local Federal reserve agent of collateral in amount equal to the sum of the Federal reserve notes thus applied for and issued pursuant to such application. The collateral security thus offered shall be notes and bills, accepted for rediscount under the provisions of section thirteen of this Act, and the Federal reserve agent shall each day notify the Federal Reserve Board of all issues and withdrawals of Federal reserve notes to and by the Federal reserve bank to which he is accredited. The said Federal Reserve Board may at any time call upon a Federal reserve bank for additional security to protect the Federal reserve notes issued to it.

Every Federal reserve bank shall maintain reserves in gold or lawful money of not less than thirty-five per centum against its deposits and reserves in gold of not less than forty per centum against its Federal reserve notes in actual circulation, and not offset by gold or lawful money deposited with the Federal reserve agent. Notes so paid out shall bear upon their faces a distinctive letter and serial number, which shall be assigned by the Federal Reserve Board to each Federal reserve bank. Whenever Federal reserve notes issued through one Federal reserve bank shall be received by another Federal reserve bank they shall be promptly returned for credit or redemption to the Federal reserve bank through which they were originally

issued No Federal reserve bank shall pay out notes issued through another under penalty of a tax of ten per centum upon the face value of notes so paid out Notes presented for redemption at the Treasury of the United States shall be paid out of the redemption fund and returned to the Federal reserve banks through which they were originally issued, and thereupon such Federal reserve bank shall, upon demand of the Secretary of the Treasury, reimburse such redemption fund in lawful money or, if such Federal reserve notes have been redeemed by the Treasurer in gold or gold certificates, then such funds shall be reimbursed to the extent deemed necessary by the Secretary of the Treasury in gold or gold certificates, and such Federal reserve bank shall, so long as any of its Federal reserve notes remain outstanding, maintain with the Treasurer in gold an amount sufficient in the judgment of the Secretary to provide for all redemptions to be made by the Treasurer Federal reserve notes received by the Treasury, otherwise than for redemption, may be exchanged for gold out of the redemption fund hereinafter provided and returned to the reserve bank through which they were originally issued, or they may be returned to such bank for the credit of the United States Federal reserve notes unfit for circulation shall be returned by the Federal reserve agents to the Comptroller of the Currency for cancellation and destruction

The Federal Reserve Board shall require each Federal reserve bank to maintain on deposit in the Treasury of the United States a sum in gold sufficient in the judgment of the Secretary of the Treasury for the redemption of the Federal reserve notes issued to such bank, but in no event less than five per centum, but such deposit of gold shall be counted and included as part of the forty per centum reserve heretofore required The board shall have the right, acting through the Federal reserve agent to grant in whole or in part or to reject entirely the application of any Federal reserve bank for Federal reserve notes, but to the extent that such application may be granted the Federal Reserve Board shall through its local Federal reserve agent supply Federal reserve notes to the bank so applying, and such bank shall be charged with the amount of such notes and shall pay such rate of interest on said amount as may be established by the Federal Reserve Board and the amount of such Federal reserve notes so issued to any such bank shall, upon delivery, together with such notes of such Federal reserve bank as may be issued under section eighteen of this Act upon security of United States two per centum Government bonds become a first and paramount lien on all the assets of such bank

Any Federal reserve bank may at any time reduce its liability for outstanding Federal reserve notes by depositing, with the Federal reserve agent, its Federal reserve notes gold gold certificates or lawful money of the United States Federal reserve notes so deposited shall not be reissued, except upon compliance with the conditions of an original issue

The Federal reserve agent shall hold such gold, gold certificates or law-

ful money available exclusively for exchange for the outstanding Federal reserve notes when offered by the reserve bank of which he is a director Upon the request of the Secretary of the Treasury the Federal Reserve Board shall require the Federal reserve agent to transmit so much of said gold to the Treasury of the United States as may be required for the exclusive purpose of the redemption of such notes

Any Federal reserve bank may at its discretion withdraw collateral deposited with the local Federal reserve agent for the protection of its Federal reserve notes deposited with it and shall at the same time substitute therefor other like collateral of equal amount with the approval of the Federal reserve agent under regulations to be prescribed by the Federal Reserve Board

In order to furnish suitable notes for circulation as Federal reserve notes, the Comptroller of the Currency shall, under the direction of the Secretary of the Treasury, cause plates and dies to be engraved in the best manner to guard against counterfeits and fraudulent alterations, and shall have printed therefrom and numbered such quantities of such notes of the denominations of \$5, \$10, \$20, \$50, \$100, as may be required to supply the Federal reserve banks Such notes shall be in form and tenor as directed by the Secretary of the Treasury under the provisions of this Act and shall bear the distinctive numbers of the several Federal reserve banks through which they are issued

When such notes have been prepared, they shall be deposited in the Treasury, or in the subtreasury or mint of the United States nearest the place of business of each Federal reserve bank and shall be held for the use of such bank, subject to the order of the Comptroller of the Currency for their delivery, as provided by this Act

The plates and dies to be procured by the Comptroller of the Currency for the printing of such circulating notes shall remain under his control and direction, and the expenses necessarily incurred in executing the laws relating to the procuring of such notes, and all other expenses incidental to their issue and retirement, shall be paid by the Federal reserve banks, and the Federal Reserve Board shall include in its estimate of expenses levied against the Federal reserve banks a sufficient amount to cover the expenses herein provided for

The examination of plates, dies, and pieces, and so forth, and regulations relating to such examination of plates, dies, and so forth, of national bank notes provided for in section fifty-one hundred and seventy-four Revised Statutes, is hereby extended to include notes herein provided for

Any appropriation heretofore made out of the general funds of the Treasury for engraving plates and dies, the purchase of distinctive paper, or to cover any other expense in connection with the printing of national bank notes or notes provided for by the Act of May thirtieth, nineteen hundred and eight, and any distinctive paper that may be on hand at the time of the passage of this Act may be used in the discretion of the Secre-

tary for the purposes of this Act, and should the appropriations heretofore made be insufficient to meet the requirements of this Act in addition to circulating notes provided for by existing law the Secretary is hereby authorized to use so much of any funds in the Treasury not otherwise appropriated for the purpose of furnishing the notes aforesaid *Provided, however*, That nothing in this section contained shall be construed as exempting national banks or Federal reserve banks from their liability to reimburse the United States for any expenses incurred in printing and issuing circulating notes

Every Federal reserve bank shall receive on deposit at par from member banks or from Federal reserve banks checks and drafts drawn upon any of its depositors, and when remitted by a Federal reserve bank checks and drafts drawn by any depositor in any other Federal reserve bank or member bank upon funds to the credit of said depositor in said reserve bank or member bank. Nothing herein contained shall be construed as prohibiting a member bank from charging its actual expense incurred in collecting and remitting funds or for exchange sold to its patrons. The Federal Reserve Board shall, by rule fix the charges to be collected by the member banks from its patrons whose checks are cleared through the Federal reserve bank and the charge which may be imposed for the service of clearing or collection rendered by the Federal reserve bank.

The Federal Reserve Board shall make and promulgate from time to time regulations governing the transfer of funds and charges therefor among Federal reserve banks and their branches, and may at its discretion exercise the functions of a clearing house for such Federal reserve banks, or may designate a Federal reserve bank to exercise such functions and may also require each bank to exercise the functions of a clearing house for its member banks.

SEC. 17 So much of the provisions of section fifty-one hundred and fifty-nine of the Revised Statutes of the United States, and section four of the Act of June twentieth, eighteen hundred and seventy-four, and section eight of the Act of July twelfth eighteen hundred and eighty-two, and of any other provisions or existing statutes as require that heretofore any national banking associations shall be authorized to commence banking business it shall transfer and deliver to the Treasurer of the United States a stated amount of United States registered bonds is hereby repealed.

REDEMPTION BONDS

SEC. 18 After two years from the passage of this Act and at any time during a period of twenty years thereafter, any member bank desiring to retire the whole or any part of its circulating notes, may file with the Treasurer of the United States an application to sell for its account, at par and accrued interest, United States bonds securing circulation to be retired.

The Treasurer shall, at the end of each quarterly period furnish the

Federal Reserve Board with a list of such applications, and the Federal Reserve Board may, in its discretion, require the Federal reserve banks to purchase such bonds from the banks whose applications have been filed with the Treasurer at least ten days before the end of any quarterly period at which the Federal Reserve Board may direct the purchase to be made. *Provided*, That Federal reserve banks shall not be permitted to purchase an amount to exceed \$25,000,000 of such bonds in any one year, and which amount shall include bonds acquired under section four of this Act by the Federal reserve bank

Provided further, That the Federal Reserve Board shall allot to each Federal reserve bank such proportion of such bonds as the capital and surplus of such bank shall bear to the aggregate capital and surplus of all the Federal reserve banks

Upon notice from the Treasurer of the amount of bonds so sold for its account, each member bank shall duly assign and transfer, in writing, such bonds to the Federal reserve banks purchasing the same, and such Federal reserve bank shall, thereupon, deposit lawful money with the Treasurer of the United States for the purchase price of such bonds, and the Treasurer shall pay to the member bank selling such bonds any balance due after deducting a sufficient sum to redeem its outstanding notes secured by such bonds, which notes shall be canceled and permanently retired when redeemed

The Federal reserve banks purchasing such bonds shall be permitted to take out an amount of circulating notes equal to the par value of such bonds

Upon the deposit with the Treasurer of the United States of bonds so purchased, or any bonds with the circulating privilege acquired under section four of this Act, any Federal reserve bank making such deposit in the manner provided by existing law, shall be entitled to receive from the Comptroller of the Currency circulating notes in blank, registered and countersigned as provided by law, equal in amount to the par value of the bonds so deposited. Such notes shall be the obligations of the Federal reserve bank procuring the same, and shall be in form prescribed by the Secretary of the Treasury, and to the same tenor and effect as national-bank notes now provided by law. They shall be issued and redeemed under the same terms and conditions as national-bank notes except that they shall not be limited to the amount of the capital stock of the Federal reserve bank issuing them

Upon application of any Federal reserve bank, approved by the Federal Reserve Board, the Secretary of the Treasury may issue, in exchange for United States two per centum gold bonds bearing the circulation privilege, but against which no circulation is outstanding, one-year gold notes of the United States without the circulation privilege, to an amount not to exceed one-half of the two per centum bonds so tendered for exchange, and thirty-year three per centum gold bonds without the circulation privilege for the remainder of the two per centum bonds so tendered. *Provided*, That at the

time of such exchange the Federal reserve bank obtaining such one-year gold notes shall enter into an obligation with the Secretary of the Treasury binding itself to purchase from the United States for gold at the maturity of such one-year notes, an amount equal to those delivered in exchange for such bonds, if so requested by the Secretary, and at each maturity of one-year notes so purchased by such Federal reserve bank, to purchase from the United States such an amount of one-year notes as the Secretary may tender to such bank, not to exceed the amount issued to such bank in the first instance, in exchange for the two per centum United States gold bonds, said obligation to purchase at maturity such notes shall continue in force for a period not to exceed thirty years

For the purpose of making the exchange herein provided for, the Secretary of the Treasury is authorized to issue at par Treasury notes in coupon or registered form as he may prescribe in denominations of one hundred dollars, or any multiple thereof, bearing interest at the rate of three per centum per annum, payable quarterly, such Treasury notes to be payable not more than one year from the date of their issue in gold coin of the present standard value, and to be exempt as to principal and interest from the payment of all taxes and duties of the United States except as provided by this Act, as well as from taxes in any form by or under State, municipal, or local authorities. And for the same purpose, the Secretary is authorized and empowered to issue United States gold bonds at par, bearing three per centum interest payable thirty years from date of issue, such bonds to be of the same general tenor and effect and to be issued under the same general terms and conditions as the United States three per centum bonds without the circulation privilege now issued and outstanding

Upon application of any Federal reserve bank, approved by the Federal Reserve Board, the Secretary may issue at par such three per centum bonds in exchange for the one-year gold notes herein provided for

BANK RESERVES

SEC 19 Demand deposits within the meaning of this Act shall comprise all deposits payable within thirty days, and time deposits shall comprise all deposits payable after thirty days, and all savings accounts and certificates of deposit which are subject to not less than thirty days' notice before payment

When the Secretary of the Treasury shall have officially announced, in such manner as he may elect, the establishment of a Federal reserve bank in any district, every subscribing member bank shall establish and maintain reserves as follows

(a) A bank not in a reserve or central reserve city as now or hereafter defined shall hold and maintain reserves equal to twelve per centum of the aggregate amount of its demand deposits and five per centum of its time deposits, as follows

In its vaults for a period of thirty-six months after said date five-twelfths thereof and permanently thereafter four-twelfths

In the Federal reserve bank of its district, for a period of twelve months after said date, two-twelfths, and for each succeeding six months an additional one-twelfth, until five-twelfths have been so deposited, which shall be the amount permanently required

For a period of thirty-six months after said date the balance of the reserves may be held in its own vaults, or in the Federal reserve bank, or in national banks in reserve or central reserve cities as now defined by law

After said thirty-six months' period said reserves, other than those hereinbefore required to be held in the vaults of the member bank and in the Federal reserve bank, shall be held in the vaults of the member bank or in the Federal reserve bank, or in both, at the option of the member bank

(b) A bank in a reserve city, as now or hereafter defined, shall hold and maintain reserves equal to fifteen per centum of the aggregate amount of its demand deposits and five per centum of its time deposits, as follows

In its vaults for a period of thirty-six months after said date six-fifteenths thereof, and permanently thereafter five-fifteenths

In the Federal reserve bank of its district for a period of twelve months after the date aforesaid at least three-fifteenths, and for each succeeding six months an additional one-fifteenth, until six-fifteenths have been so deposited, which shall be the amount permanently required

For a period of thirty-six months after said date the balance of the reserves may be held in its own vaults, or in the Federal reserve bank, or in national banks in reserve or central reserve cities as now defined by law

After said thirty-six months' period all of said reserves, except those hereinbefore required to be held permanently in the vaults of the member bank and in the Federal reserve bank, shall be held in its vaults or in the Federal reserve bank, or in both, at the option of the member bank

(c) A bank in a central reserve city, as now or hereafter defined, shall hold and maintain a reserve equal to eighteen per centum of the aggregate amount of its demand deposits and five per centum of its time deposits, as follows

In its vaults six-eighteenths thereof

In the Federal reserve bank seven-eighteenths

The balance of said reserves shall be held in its own vaults or in the Federal reserve bank, at its option

Any Federal reserve bank may receive from the member banks as reserves, not exceeding one-half of each installment, eligible paper as described in section fourteen properly indorsed and acceptable to the said reserve bank

If a State bank or trust company is required by the law of its State to keep its reserves either in its own vaults or with another State bank or trust company, such reserve deposits so kept in such State bank or trust company shall be construed, within the meaning of this section, as if they

were reserve deposits in a national bank in a reserve or central reserve city for a period of three years after the Secretary of the Treasury shall have officially announced the establishment of a Federal reserve bank in the district in which such State bank or trust company is situate Except as thus provided, no member bank shall keep on deposit with any nonmember bank a sum in excess of ten per centum of its own paid-up capital and surplus No member bank shall act as the medium or agent of a nonmember bank in applying for or receiving discounts from a Federal reserve bank under the provisions of this Act except by permission of the Federal Reserve Board

The reserve carried by a member bank with a Federal reserve bank may, under the regulations and subject to such penalties as may be prescribed by the Federal Reserve Board, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities *Provided, however,* That no bank shall at any time make new loans or shall pay any dividends unless and until the total reserve required by law is fully restored

In estimating the reserves required by this Act, the net balance of amounts due to and from other banks shall be taken as the basis for ascertaining the deposits against which reserves shall be determined Balances in reserve banks due to member banks shall, to the extent herein provided, be counted as reserves

National banks located in Alaska or outside the continental United States may remain nonmember banks, and shall in that event maintain reserves and comply with all the conditions now provided by law regulating them, or said banks, except in the Philippine Islands, may, with the consent of the Reserve Board, become member banks of any one of the reserve districts, and shall, in that event, take stock, maintain reserves, and be subject to all the other provisions of this Act

SEC 20 So much of sections two and three of the Act of June twentieth, eighteen hundred and seventy-four, entitled "An Act fixing the amount of United States notes, providing for a redistribution of the national-bank currency, and for other purposes," as provides that the fund deposited by any national banking association with the Treasurer of the United States for the redemption of its notes shall be counted as a part of its lawful reserve as provided in the Act aforesaid, is ~~is~~ ^{is} ~~same~~ repealed And from and after the passage of this Act such fund of ~~three~~ ^{three} per centum shall in no case be counted by any national banking association as a part of its lawful reserve

BANK EXAMINATIONS

SEC 21 Section fifty-two hundred and forty, United States Revised Statutes, is amended to read as follows

The Comptroller of the Currency, with the approval of the Secretary of the Treasury, shall appoint examiners who shall examine every member

bank at least twice in each calendar year and oftener if considered necessary *Provided, however,* That the Federal Reserve Board may authorize examination by the State authorities to be accepted in the case of State banks and trust companies and may at any time direct the holding of a special examination of State banks or trust companies that are stockholders in any Federal reserve bank. The examiner making the examination of any national bank, or of any other member bank, shall have power to make a thorough examination of all the affairs of the bank and in doing so he shall have power to administer oaths and to examine any of the officers and agents thereof under oath and shall make a full and detailed report of the condition of said bank to the Comptroller of the Currency.

The Federal Reserve Board, upon the recommendation of the Comptroller of the Currency, shall fix the salaries of all bank examiners and make report thereof to Congress. The expense of the examinations herein provided for shall be assessed by the Comptroller of the Currency upon the banks examined in proportion to assets or resources held by the banks upon the dates of examination of the various banks.

In addition to the examinations made and conducted by the Comptroller of the Currency, every Federal reserve bank may, with the approval of the Federal reserve agent or the Federal Reserve Board, provide for special examination of member banks within its district. The expense of such examinations shall be borne by the bank examined. Such examinations shall be so conducted as to inform the Federal reserve bank of the condition of its member banks and of the lines of credit which are being extended by them. Every Federal reserve bank shall at all times furnish to the Federal Reserve Board such information as may be demanded concerning the condition of any member bank within the district of the said Federal reserve bank.

No bank shall be subject to any visitatorial powers other than such as are authorized by law, or vested in the courts of justice or such as shall be or shall have been exercised or directed by Congress, or by either House thereof or by any committee of Congress or of either House duly authorized.

The Federal Reserve Board shall, at least once each year, order an examination of each Federal reserve bank, and upon joint application of ten member banks the Federal Reserve Board shall order a special examination and report of the condition of any Federal reserve bank.

SEC. 22 No member bank or any officer, director, or employee thereof shall hereafter make any loan or grant any gratuity to any bank examiner. Any bank officer, director, or employee violating this provision shall be deemed guilty of a misdemeanor and shall be imprisoned not exceeding one year or fined not more than \$5,000, or both, and may be fined a further sum equal to the money so loaned or gratuity given. Any examiner accepting a loan or gratuity from any bank examined by him or from an officer, director, or employee thereof shall be deemed guilty of a misdemeanor and

shall be imprisoned not exceeding one year or fined not more than \$5,000, or both, and may be fined a further sum equal to the money so loaned or gratuity given, and shall forever thereafter be disqualified from holding office as a national-bank examiner. No national-bank examiner shall perform any other service for compensation while holding such office for any bank or officer, director, or employee thereof.

Other than the usual salary or director's fee paid to any officer, director, or employee of a member bank and other than a reasonable fee paid by said bank to such officer, director, or employee for services rendered to such bank, no officer, director, employee, or attorney of a member bank shall be a beneficiary of or receive, directly or indirectly, any fee, commission, gift, or other consideration for or in connection with any transaction or business of the bank. No examiner, public or private, shall disclose the names of borrowers or the collateral for loans of a member bank to other than the proper officers of such bank without first having obtained the express permission in writing from the Comptroller of the Currency, or from the board of directors of such bank, except when ordered to do so by a court of competent jurisdiction, or by direction of the Congress of the United States, or of either House thereof, or any committee of Congress or of either House duly authorized. Any person violating any provision of this section shall be punished by a fine of not exceeding \$5,000 or by imprisonment not exceeding one year, or both.

Except as provided in existing laws, this provision shall not take effect until sixty days after the passage of this Act.

SEC 23 The stockholders of every national banking association shall be held individually responsible for all contracts, debts, and engagements of such association up to the amount of his stock therein, at the par value thereof in addition to the amount invested in such stock. The stockholders in any national banking association who shall have transferred their shares or registered the transfer thereof within sixty days next before the date of the failure of such association to meet its obligations or with knowledge of such impending failure shall be liable to the same extent as if they had made no such transfer, to the extent that the subsequent trustee fails to meet such liability but this provision shall not be construed to affect in any way any recourse which such shareholders might otherwise have against those in whose names such shares are registered at the time of such failure.

LOANS ON FARM LANDS

SEC 24 Any national banking association not situated in a central reserve city may make loans secured by improved and unencumbered farm land situated within its Federal reserve district, but no such loan shall be made for a longer time than five years, nor for an amount exceeding fifty per centum of the actual value of the property offered as security. Any such bank may make such loans in an aggregate sum equal to twenty-five per centum of its capital and surplus or to one-third of its time deposits and

such banks may continue hereafter as heretofore to receive time deposits and to pay interest on the same

The Federal Reserve Board shall have power from time to time to add to the list of cities in which national banks shall not be permitted to make loans secured upon real estate in the manner described in this section

FOREIGN BRANCHES

SEC 25 Any national banking association possessing a capital and surplus of \$1,000,000 or more may file application with the Federal Reserve Board, upon such conditions and under such regulations as may be prescribed by the said board, for the purpose of securing authority to establish branches in foreign countries or dependencies of the United States for the furtherance of the foreign commerce of the United States, and to act, if required to do so, as fiscal agents of the United States. Such application shall specify, in addition to the name and capital of the banking association filing it, the place or places where the banking operations proposed are to be carried on, and the amount of capital set aside for the conduct of its foreign business. The Federal Reserve Board shall have power to approve or to reject such application if, in its judgment, the amount of capital proposed to be set aside for the conduct of foreign business is inadequate, or if for other reasons the granting of such application is deemed inexpedient.

Every national banking association which shall receive authority to establish foreign branches shall be required at all times to furnish information concerning the condition of such branches to the Comptroller of the Currency upon demand, and the Federal Reserve Board may order special examinations of the said foreign branches at such time or times as it may deem best. Every such national banking association shall conduct the accounts of each foreign branch independently of the accounts of other foreign branches established by it and of its home office, and shall at the end of each fiscal period transfer to its general ledger the profit or loss accruing at each branch as a separate item.

SEC 26 All provisions of law inconsistent with or superseded by any of the provisions of this Act are to that extent and to that extent only hereby repealed. *Provided*, Nothing in this Act contained shall be construed to repeal the parity provision or provisions contained in an Act approved March fourteenth, nineteen hundred, entitled "An Act to define and fix the standard of value, to maintain the parity of all forms of money issued or coined by the United States, to refund the public debt, and for other purposes," and the Secretary of the Treasury may for the purpose of maintaining such parity and to strengthen the gold reserve, borrow gold on the security of United States bonds authorized by section two of the Act last referred to or for one-year gold notes bearing interest at a rate of not to exceed three per centum per annum, or sell the same if necessary to obtain gold. When the funds of the Treasury on hand justify, he may purchase and retire such outstanding bonds and notes.

SEC 27 The provisions of the Act of May thirtieth, nineteen hundred and eight, authorizing national currency associations, the issue of additional national-bank circulation, and creating a National Monetary Commission, which expires by limitation under the terms of such Act on the thirtieth day of June, nineteen hundred and fourteen, are hereby extended to June thirtieth, nineteen hundred and fifteen, and sections fifty-one hundred and fifty-three, fifty-one hundred and seventy-two, fifty-one hundred and ninety-one, and fifty-two hundred and fourteen of the Revised Statutes of the United States, which were amended by the Act of May thirtieth, nineteen hundred and eight, are hereby reenacted to read as such sections read prior to May thirtieth, nineteen hundred and eight, subject to such amendments or modifications as are prescribed in this Act *Provided, however,* That section nine of the Act first referred to in this section is hereby amended so as to change the tax rates fixed in said Act by making the portion applicable thereto read as follows:

National banking associations having circulating notes secured otherwise than by bonds of the United States shall pay for the first three months a tax at the rate of three per centum per annum upon the average amount of such of their notes in circulation as are based upon the deposit of such securities, and afterwards an additional tax rate of one-half of one per centum per annum for each month until a tax of six per centum per annum is reached, and thereafter such tax of six per centum per annum upon the average amount of such notes.

SEC 28 Section fifty-one hundred and forty-three of the Revised Statutes is hereby amended and reenacted to read as follows: Any association formed under this title may by the vote of shareholders owning two-thirds of its capital stock, reduce its capital to any sum not below the amount required by this title to authorize the formation of associations, but no such reduction shall be allowable which will reduce the capital of the association below the amount required for its outstanding circulation, nor shall any reduction be made until the amount of the proposed reduction has been reported to the Comptroller of the Currency and such reduction has been approved by the said Comptroller of the Currency and by the Federal Reserve Board, or by the organization committee pending the organization of the Federal Reserve Board.

SEC 29 If any clause, sentence, paragraph, or part of this Act shall for any reason be adjudged by any court of competent jurisdiction to be invalid such judgment shall not affect, impair, or invalidate the remainder of this Act, but shall be confined in its operation to the clause, sentence, paragraph or part thereof directly involved in the controversy in which such judgment shall have been rendered.

SEC 30 The right to amend, alter, or repeal this Act is hereby expressly reserved.

Approved, December 23, 1913

APPENDIX VII

OWEN BILL¹

A BILL

To establish associations of national and other banks and trust companies, to be known as reserve banks, under the supervision of a National Currency Board, to mobilize reserves, to provide additional circulation when required for national commerce, and for other purposes

Be It Enacted by the Senate and House of Representatives of the United States of America in Congress Assembled,

DEFINITIONS

That the term "reserve bank," as used in this Act, means a reserve bank incorporated in accordance with the terms hereof

"Member bank" means one of the subscribing banks of a reserve bank,

"Reserve district" means one of the districts within which a reserve bank is located under the authority of this Act,

"Prime commercial paper" means a commercial bill, payable within four months, signed by at least two persons, either of whom shall be good for such bill and one of whom shall be a member bank, such commercial bill to be based upon an actual commercial transaction and not to be based upon a permanent investment,

"Treasury gold note" means a note issued by the United States Treasury, based on the credit of the United States and printed in the form to be prescribed by the National Currency Board, payable on demand at any reserve bank or at the Treasury of the United States,

"The National Currency Board" shall mean the board of governors of the national currency, as described in this Act

SEC 2 That the New England Reserve Bank, the Eastern Reserve Bank, the Southeastern Reserve Bank, the Southern Reserve Bank, the Central States Reserve Bank, the Rocky Mountain Reserve Bank, the Southwestern Reserve Bank, and the Pacific Reserve Bank be, and are hereby, created and established for a term of thirty years from the date of filing with the Comptroller of the Currency a certificate of paid-in capital stock as hereinafter provided

¹ May, 1913

The head office of the New England Reserve Bank shall be located in Boston, of the Eastern Reserve Bank in New York, of the Southeastern Reserve Bank in Atlanta, of the Southern Reserve Bank in New Orleans, of the Central States Reserve Bank in Chicago, of the Southwestern Reserve Bank in Kansas City, of the Rocky Mountain Reserve Bank in Denver, and of the Pacific Reserve Bank in San Francisco

TERMS OF SUBSCRIPTION

SEC 3 That within six months from the date of the passage of this Act every national bank shall subscribe to the capital of the reserve bank of its district, to an amount equal to twenty per centum of the paid-in and unimpaired and surplus capital of the subscribing bank and not more nor less

Fifty per centum of the subscriptions to the capital stock of the reserve bank shall be fully paid in within six months at the time and places fixed by the National Currency Board and the remainder of the subscriptions, any part thereof, shall become a liability of the subscribers, subject to call and payment thereof whenever necessary to meet the obligations of the reserve bank, under such terms and in accordance with such regulations as the board of directors of the reserve bank may prescribe

Any bank or trust company incorporated under the laws of any State or of the District of Columbia may subscribe to the capital of the reserve bank of its district according to the same terms and proportions as a national bank if it complies with the following conditions

First That (a) it shall have a paid-in and unimpaired capital of not less than that required for a national bank in the same locality, and (b) if a trust company it shall have an unimpaired capital and surplus of fifty per centum more than the amount of capital required for a national bank in the same locality

Second Keep a like reserve as required of the national banks in their own vaults and with the reserve bank

Third Agree to proper examinations as may be required by the National Currency Board

Fourth That it shall agree to comply with all other requirements and conditions imposed by this Act and regulations made in conformity therewith

No member bank shall serve as an intermediary by which any bank or trust company not a stockholder of a reserve bank, shall receive the benefits arising under the provisions of this Act

No member bank shall pay interest upon the funds of other banks or trust companies deposited with it

THE ORGANIZATION COMMITTEE

SEC 4 That the Secretary of the Treasury, the Attorney General and the Comptroller of the Currency are hereby designated a committee to effect

the organization of the reserve banks They shall divide the entire country into eight districts, which shall be apportioned with due regard to the convenient and customary course of business and not necessarily along State lines, and within sixty days after the passage of this Act they shall provide for the opening of books for subscription to the capital stock of the reserve banks The necessary expenses of this committee shall be paid out of the Treasury upon vouchers approved by the members of said committee, and the Treasury shall be reimbursed by the reserve banks to the full amount paid out therefor

The subscribing banks uniting to form a reserve bank shall make and file with the Comptroller of the Currency an organization certificate in the form and manner described in sections fifty-one hundred and thirty-four, fifty-one hundred and thirty-five, and fifty-one hundred and thirty-six, Revised Statutes of the United States, signed by their authorized representatives, and they shall then become a body corporate, and, as such, shall have power to perform all those acts, enjoy all those privileges, and exercise all those powers described in section fifty-one hundred and thirty-six, Revised Statutes, save in so far as the same shall be limited or extended by the provisions of this Act

THE BOARDS AND OFFICERS OF THE RESERVE BANKS

SEC 5 That each reserve bank shall be organized and conducted under the oversight and control of a board of directors, whose powers shall be the same as those conferred upon the boards of directors of national banking associations under existing law, except as otherwise provided in this Act Such boards shall consist of nine members holding office for six years, to be chosen in the following manner

Six directors shall be elected by the several subscribing banks, each bank having one unit of voting power for each million or fraction thereof of its capital Each unit of voting power shall have as many votes as there are directors to be elected, and these votes may be given in favor of any or all of the candidates for election Three directors shall be appointed by the President of the United States from a list furnished by the National Currency Board to be hereafter provided for, and shall fairly represent the agricultural, commercial, manufacturing, and other interests of the district

The manager of the reserve bank shall be elected by the board of directors of the bank and shall thereafter be ex officio presiding officer of that board, but shall have no vote unless the board be equally divided Until the organization of the National Currency Board and the appointments of its representatives upon the board of a reserve bank the elected members of such board shall have full power to act

No director of a reserve bank shall be, while serving, an officer or a director of any bank or trust company

At the first meeting of the full board of directors of each reserve bank

the members of the board shall be divided into three classes, whose terms of office shall expire at intervals of two, four, and six years, respectively, estimated from the first day of January, nineteen hundred and fourteen. Two of the directors chosen by the member banks and one of the directors appointed by the President shall belong to each class. Thereafter all directors chosen as hereinbefore provided shall be chosen for terms of six years.

BOARD OF GOVERNORS OF THE NATIONAL CURRENCY

SEC 6 That there shall be created a board of governors of the national currency, to consist of seven members, including the Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency, ex officio, and four governors, to be appointed by the President of the United States, and to serve subject to his will, one of whom shall be distinguished for his practical knowledge of the commerce of the United States, one for his practical knowledge of the manufacturing business, one for his practical knowledge of transportation and one who shall be distinguished for his knowledge of banking and credit. The Secretary of the Treasury shall be ex officio chairman but the board of governors may select its own chairman pro tempore. All expenses of the board, including the cost of necessary offices and the salaries of its members shall be apportioned among and paid by the reserve banks in proportion to their capital. The salaries of the members of the board shall be determined by a majority of the reserve banks, each bank having one vote and no salary shall be reduced during the term of an appointment.

The National Currency Board shall have authority to make by-laws not inconsistent with law, which shall prescribe the manner in which the duties of the board shall be fulfilled and the privileges granted to it by law exercised and enjoyed.

CAPITAL OF THE RESERVE BANKS

SEC 7 That each reserve bank shall have an authorized capital equal in amount to twenty per centum of the paid-in and unpaired capital and surplus of all banks eligible for membership in the said reserve bank. Such reserve bank shall be authorized to commence business upon the approval of the National Currency Board and a certificate of the Comptroller of the Currency.

The capital stock of the reserve bank shall be divided into shares of \$100 each. These shares shall not be transferable and under no circumstances shall they be hypothecated, nor shall they be owned otherwise than by member banks, nor shall they be owned by any such bank other than in the proportions herein provided. In case a member bank increases its capital

it shall thereupon subscribe for an additional amount of the capital of its reserve bank, equal to twenty per centum of the member banks increase of capital, paying therefor the then book value as shown by the last published statement of said reserve bank

A bank applying for membership in a reserve bank at any time after its formation must subscribe for an amount of the capital of said reserve bank equal to twenty per centum of the capital and surplus of the subscribing bank, paying therefor its then book value as shown by the last published statement. In case a member bank reduces its capital it shall surrender a proportionate amount of its holdings in the capital of said reserve bank, and if a member bank goes into voluntary liquidation it shall surrender all of its holdings of the capital of said reserve bank. In either case the shares surrendered shall be canceled, and the member bank shall receive in payment therefor from the reserve bank a sum equal to the then book value of the reserve bank as shown by its last published statement, and the capital of the reserve bank shall be reduced correspondingly

If any member bank shall become insolvent and a receiver be appointed, the stock held by it in said reserve bank shall be canceled, the insolvent bank credited with the value thereof, and the balance, after paying all debts due by such insolvent bank to said reserve bank (such debts being hereby declared to be a first lien upon the paid-in capital stock held by such member), shall be paid to the receiver of the insolvent bank

Except as hereinbefore provided, no member bank may withdraw from membership in a reserve bank until after one year's notice of such intention to withdraw, and in such case the member bank shall receive from the reserve bank a sum equal to the book value of its stock on the date of withdrawal

A certificate of all increases and decreases of the capital of each reserve bank shall be immediately filed with the Comptroller of the Currency. Each reserve bank shall cause to be kept at all times a full and correct list of the names of the banks owning its stock and the number of shares held by each. Such list shall be subject to inspection of all the shareholders of the reserve bank, and a copy thereof shall be transmitted on the first of July of each year to the Comptroller of the Currency and at any other time required by the Comptroller of the Currency

EARNINGS OF THE RESERVE BANKS

SEC 8 That the earnings of each reserve bank shall be disposed of in the following manner. After the payment of all expenses, including the expenses of the National Currency Board, the shareholders shall be entitled to receive an annual dividend of five per centum on the paid-in capital, which dividend shall be cumulative. Further annual net earnings shall be paid into the surplus fund of the reserve bank until that fund shall amount

to twenty per centum of the paid-in capital, and thereafter all earnings in excess of five per centum per annum shall be paid to the United States

The reserve bank shall be exempt from local and State taxation, except in respect to taxes upon real estate and from all Federal taxes except such as are provided by this Act

FUNCTIONS OF THE RESERVE BANKS

SEC 9 That the reserve banks shall be the fiscal agents of the United States All moneys now held in the general fund of the Treasury shall, within six months from the passage of this Act, be deposited in the reserve banks, and thereafter the revenues of the Government shall be deposited in such banks and disbursements shall be made by check drawn against such deposits It shall be the duty of the National Currency Board herein established to apportion the funds and revenues of the Government among the several reserve banks

The Government of the United States, reserve banks owning stock in a reserve bank, and the officers of the United States shall be the only depositors in such banks All domestic transactions of the reserve banks shall be confined to the Government, the officers of the United States, member banks and other reserve banks with the exception of the purchase or sale of Government or State securities or securities of foreign governments, or of gold coin or bullion

No reserve bank shall pay interest on deposits

A reserve bank may discount, purchase, and sell notes, bills of exchange, and acceptances issued or drawn for agricultural, industrial, or commercial purposes, provided, first, that they have no more than three months to run, and, second, that they bear the indorsement of one or more of its member banks The amount so discounted for any subscriber shall at no time exceed the capital and surplus of the subscribing bank The aggregate of such notes, bills, and acceptances made by any one person, company, firm, or corporation discounted for any one bank shall at no time exceed ten per centum of the unimpaired capital and surplus of said banks

A reserve bank may discount and purchase notes, bills, and acceptances of the character above described from another reserve bank, provided that they bear the indorsement of said reserve bank

A reserve bank may, with the specific approval of the National Currency Board, discount the direct obligation of one of its member banks Provided, That the application is secured by the pledge and deposit with it of satisfactory securities, which shall be held by the reserve bank In no case shall the amount loaned by the reserve bank exceed three-fourths of the value of the security so pledged, and in case the value of such security should depreciate, the reserve bank may require additional collateral to the extent of such depreciation

A reserve bank may invest in United States bonds, also in obligations

having not more than one year to run of the United States or its dependencies, or of any State, or of foreign governments

A reserve bank may, with the consent of the National Currency Board, open and maintain banking accounts in foreign countries and establish agencies in such countries for the purpose of purchasing, selling, and collecting foreign bills of exchange and foreign government obligations of the kinds named in this Act, and it shall have authority to buy and sell, with or without its endorsement, checks or bills of exchange, payable in foreign countries, arising out of commercial transactions which have not exceeding ninety days to run and which bear the signature of two or more responsible parties

A reserve bank may purchase, acquire, hold, and convey real estate for the same purposes and under the same restrictions as are described in section fifty-one hundred and thirty-seven, Revised Statutes of the United States, for the national banks

The reserve banks shall have power to lend to and borrow from each other, to deal in gold coin or bullion, to make loans thereon, and to contract for loans of gold coin or bullion, giving therefor, when necessary, acceptable security

A reserve bank shall, upon request, transfer any part of the deposit balance of any depositor to the credit of any other depositor in any reserve bank. The regulations under which such transfer shall be made and the transfer charges shall be fixed by the National Currency Board

FUNCTIONS OF THE BOARD OF GOVERNORS OF THE NATIONAL CURRENCY

SEC 10 That the National Currency Board shall be authorized and empowered—

First To exercise general supervision over the reserve banks and to examine at will the accounts and books of national banks and of all reserve banks

Second To determine the apportionment of Treasury deposits and revenues among the national reserve banks

Third To readjust the boundaries of the districts of the reserve banks and to authorize the establishment of agencies within these districts whenever in their opinion the business of the country requires

Fourth To provide regulations and to establish charges for the transfer of deposits from accounts kept with one reserve bank to accounts kept with another

Fifth To supervise the issue of national currency as provided by this Act

Sixth To suspend for a period not exceeding thirty days (and to renew such suspension for a period not to exceed fifteen days) any and every reserve requirement specified in this Act.

RESERVES OF MEMBER BANKS

SEC 11 That within two years from the date when the Secretary of the Treasury shall have officially announced that a reserve bank has been established within a given district, and as rapidly as practicable, every member bank within the said district shall establish and thereafter maintain a reserve of cash in its own vaults, or of balance with the reserve bank, equal to not less than fifteen per centum of its total outstanding demand liabilities, and of this reserve no less than one-half shall be kept as a balance with the reserve bank. All liabilities maturing within thirty days shall be construed to be demand liabilities within the meaning of this Act. All Acts or parts of Acts requiring the maintenance of other reserves in national banks against demand liabilities are hereby repealed.

RESERVES OF THE RESERVE BANKS

SEC 12 That all demand liabilities of a reserve bank shall be covered to the extent of fifty per centum by a reserve of gold (including gold bullion and foreign gold coin) or other legal tender money of the United States. Provided, That whenever and so long as such reserve shall fall and remain below fifty per centum the reserve bank shall pay for the first month or fraction thereof a special tax at the rate of five per centum per annum upon the deficiency of the reserve, and thereafter an additional tax of one per centum per annum for each month until a tax of ten per centum per annum is reached, and thereafter such tax of ten per centum per annum upon the average amount of such notes. Whenever and so long as such a deficiency in the reserve exists the minimum discount rate with the reserve bank shall be maintained at not less than the rate of the tax.

NOTE CIRCULATION

SEC 13 That the Comptroller of the Currency is hereby authorized, with the approval and under regulations to be prescribed by the National Currency Board, to issue United States Treasury gold notes to the reserve banks, said notes to be redeemable in gold on presentation at any reserve bank, or at the office of the Treasurer of the United States. The United States shall have a paramount lien upon all of the assets of the reserve bank to which said notes are issued to the extent of such notes retained by said reserve bank, and until such notes or an equal amount of lawful money are returned to the Treasury of the United States. Any reserve bank receiving such notes shall be required to redeem them on demand, in gold, and shall set apart in its own vaults prime commercial paper as collateral security for the return of such notes or an equivalent in lawful money, to the Treasurer of the United States.

Such Treasury gold notes shall be issued in a form to be prescribed by the National Currency Board.

A reserve bank to which such Treasury gold notes are issued shall pay during the first four months during which such notes are held and retained at the rate of three per centum per annum for the use of such notes, and at the rate of one per centum per annum for each additional month or fraction thereof until a tax of ten per centum per annum is reached, and thereafter a tax of ten per centum per annum upon the average amount of such notes until they are returned to the Treasury

MEMORANDUM

NOTE—The security of these notes is first, a first lien on the assets of the reserve bank, second, prime commercial paper of like amount collateral in the hands of the bank, third, the credit of the United States

The Banks will have abundant gold in their hands to keep these notes at par Any person desiring gold can easily get gold on the thousands of millions of outstanding gold certificates These notes for commercial purposes intended to be used as a means of discounting prime commercial paper and furnishing a prompt and open market for prime commercial paper would be distributed to the local banks desiring currency for moving the crops, etc

The United States Government might, if it were deemed worth while at all, acquire a small gold deposit to cover any of these notes offered for redemption in gold at the Treasury

The Subtreasury should be abolished and the Government deposits placed with the reserve banks The currency board should have authority to require the reserve banks to keep an open account with the Treasurer of the United States and each of them

REPORTS AND EXAMINATIONS

SEC 14 That the reserve banks shall make reports showing the principal items of their balance sheets to the Comptroller of the Currency once a week, which reports shall be made public In addition, full reports shall be made to the Comptroller of the Currency by the reserve bank and coincident with the five reports called for each year from the national banks

The National Currency Board shall, as often as deemed necessary or proper, directly or through representatives, examine the affairs of the reserve banks

All member banks shall, under regulations to be prescribed by the National Currency Board, report monthly, or oftener, if required, to their reserve banks, showing the principal items of their balance sheets

It shall be the duty of a reserve bank to examine the condition of all member banks at such times and under such regulations as the National Currency Board may determine The reserve bank may, however, accept for this purpose the reports of the national-bank examiners of member national banks and also copies of the reports of State bank examiners for member State banks and trust companies in States where the furnishing of such information is not contrary to law

A reserve bank may make such payments to national and State examiners for such services required of them as the directors may consider just and equitable. All reports of national-banks examiners in regard to the condition of banks shall hereafter be made in duplicate, and one copy shall be filed with the appropriate reserve bank for the confidential use of its executive officers. The reports of all examinations conducted by or for the reserve banks shall be held strictly confidential and for the exclusive use of the executive officers of the reserve bank.

APPENDIX VIII

AMENDMENT TO SECTION TWENTY-SEVEN OF THE FEDERAL RESERVE ACT

(Approved August 4, 1914)

That section twenty-seven of the act approved December twenty-third, nineteen hundred and thirteen, known as the Federal reserve act, is hereby amended and reenacted to read as follows

"SEC 27 The provisions of the act of May thirtieth, nineteen hundred and eight, authorizing national currency associations, the issue of additional national-bank circulation, and creating a National Monetary Commission, which expires by limitation under the terms of such act on the thirtieth day of June, nineteen hundred and fourteen, are hereby extended to June thirtieth, nineteen hundred and fifteen, and sections fifty-one hundred and fifty-three, fifty-one hundred and seventy-two, fifty-one hundred and ninety-one, and fifty-two hundred and fourteen of the Revised Statutes of the United States, which were amended by the act of May thirtieth, nineteen hundred and eight, are hereby reenacted to read as such sections read prior to May thirtieth, nineteen hundred and eight, subject to such amendments or modifications as are prescribed in this act *Provided, however,* That section nine of the act first referred to in this section is hereby amended so as to change the tax rates fixed in said act by making the portion applicable thereto read as follows

"National banking associations having circulating notes secured otherwise than by bonds of the United States, shall pay for the first three months a tax at the rate of three per centum per annum upon the average amount of such of their notes in circulation as are based upon the deposit of such securities, and afterwards an additional tax rate of one-half of one per centum per annum for each month until a tax of six per centum per annum is reached, and thereafter such tax of six per centum per annum upon the average amount of such notes *Provided further,* That whenever in his judgment he may deem it desirable, the Secretary of the Treasury shall have power to suspend the limitations imposed by section one and section three of the act referred to in this section, which prescribe that such additional circulation secured otherwise than by bonds of the United States shall be issued only to national banks having circulating notes outstanding

secured by the deposit of bonds of the United States to an amount not less than forty per centum of the capital stock of such banks, and to suspend also the conditions and limitations of section five of said act except that no bank shall be permitted to issue circulating notes in excess of one hundred and twenty-five per centum of its unimpaired capital and surplus. He shall require each bank and currency association to maintain on deposit in the Treasury of the United States a sum in gold sufficient in his judgment for the redemption of such notes, but in no event less than five per centum. He may permit national banks, during the period for which such provisions are suspended, to issue additional circulation under the terms and conditions of the act referred to as herein amended. *Provided further,* That the Secretary of the Treasury, in his discretion, is further authorized to extend the benefits of this act to all qualified State banks and trust companies, which have joined the Federal reserve system, or which may contract to join within fifteen days after the passage of this act."

APPENDIX IX

AMENDMENT TO SECTION OF THE FEDERAL RESERVE ACT RELATING TO RESERVES

(Approved August 15, 1914)

That section nineteen, subsections (b) and (c) of the act approved December twenty-third, nineteen hundred and thirteen, known as the Federal reserve act, be amended and reenacted so as to read as follows

"(b) A bank in a reserve city, as now or hereafter defined, shall hold and maintain reserves equal to fifteen per centum of the aggregate amount of its demand deposits and five per centum of its time deposits, as follows

"In its vaults for a period of thirty-six months after said date, six-fifteenths thereof, and permanently thereafter five-fifteenths

"In the federal reserve bank of its district for a period of twelve months after the date aforesaid, at least three-fifteenths, and for each succeeding six months an additional one-fifteenth, until six-fifteenths have been so deposited, which shall be the amount permanently required

"For a period of thirty-six months after said date the balance of the reserves may be held in its own vaults, or in the federal reserve bank, or in national banks in central reserve cities, as now defined by law

"After said thirty-six months' period all of said reserves, except those hereinbefore required to be held permanently in the vaults of the member bank and in the federal reserve bank, shall be held in its vaults or in the federal reserve bank or in both, at the option of the member bank

"(c) A bank in a central reserve city, as now or hereafter defined, shall hold and maintain a reserve equal to eighteen per centum of the aggregate amount of its demand deposits and five per centum of its time deposits, as follows

"In its vaults, six-eighteenths thereof

"In the federal reserve bank, seven-eighteenths

"The balance of said reserves shall be held in its own vaults or in the federal reserve bank, at its option

"Any federal reserve bank may receive from the member banks as reserves not exceeding one-half of each installment, eligible paper as described in section thirteen properly indorsed and acceptable to the said reserve bank

"If a state bank or trust company is required or permitted by the law of its State to keep its reserves either in its own vaults or with another State bank or trust company or with a national bank, such reserve deposits so kept in such State bank, trust company, or national bank shall be construed within the meaning of this section as if they were reserve deposits in a national bank in a reserve or central reserve city for a period of three years after the Secretary of the Treasury shall have officially announced the establishment of a Federal reserve bank in the district in which such State bank or trust company is situate. Except as thus provided, no member bank shall keep on deposit with any nonmember bank a sum in excess of ten per centum of its own paid-up capital and surplus. No member bank shall act as the medium or agent of a nonmember bank in applying for or receiving discounts from a Federal reserve bank under the provisions of this act except by permission of the Federal Reserve Board.

"The reserve carried by a member bank with a federal reserve bank may, under the regulations and subject to such penalties as may be prescribed by the Federal Reserve Board, be checked against and withdrawn by such member bank for the purposes of meeting existing liabilities. *Provided, however,* That no bank shall at any time make new loans or shall pay any dividends unless and until the total reserve required by law is fully restored.

"In estimating the reserves required by this act, the net balance of amounts due to and from other banks shall be taken as the basis for ascertaining the bank deposits against which reserves shall be determined. Balances in reserve banks due to member banks shall, to the extent herein provided, be counted as reserves.

"National banks located in Alaska or outside the continental United States may remain nonmember banks, and shall in that event maintain reserves and comply with all the conditions now provided by law regulating them, or said banks, except in the Philippine Islands, may, with the consent of the Reserve Board, become member banks of any one of the reserve districts, and shall, in that event, take stock, maintain reserves, and be subject to all the other provisions of this act."

APPENDIX X

AMENDMENT TO THE FEDERAL RESERVE ACT RELATING TO ACCEPTANCES

(Approved March 3, 1915)

That section thirteen, paragraphs three, four, and five, of the Act approved December twenty-third, nineteen hundred and thirteen, known as the Federal reserve act, be amended and reenacted so as to read as follows

"Any federal reserve bank may discount acceptances which are based on the importation or exportation of goods and which have a maturity at time of discount of not more than three months and indorsed by at least one member bank. The amount of acceptances so discounted shall at no time exceed one-half the paid-up and unimpaired capital stock and surplus of the bank for which the rediscounts are made, except by authority of the Federal Reserve Board, under such general regulations as said Board may prescribe, but not to exceed the capital stock and surplus of such bank.

"The aggregate of such notes and bills bearing the signature or indorsement of any one person, company, firm, or corporation rediscounted for any one bank shall at no time exceed ten per centum of the unimpaired capital and surplus of said bank, but this restriction shall not apply to the discount of bills of exchange drawn in good faith against actually existing values.

"Any member bank may accept drafts or bills of exchange drawn upon it and growing out of transactions involving the importation or exportation of goods having not more than six months sight to run, but no bank shall accept such bills to an amount equal at any time in the aggregate to more than one-half of its paid-up and unimpaired capital stock and surplus, except by authority of the Federal Reserve Board, under such general regulations as said Board may prescribe, but not to exceed the capital stock and surplus of such bank, and such regulations shall apply to all banks alike regardless of the amount of capital stock and surplus."

APPENDIX XI

AMENDMENTS TO CERTAIN SECTIONS OF THE FEDERAL RESERVE ACT

(Approved September 7, 1916)

That the act entitled "Federal Reserve Act," approved December twenty-third, nineteen hundred and thirteen, be, and is hereby, amended as follows:

At the end of section eleven insert a new clause as follows:

"(m) Upon the affirmative vote of not less than five of its members the Federal Reserve Board shall have power from time to time, by general ruling, covering all districts alike, to permit member banks to carry in the Federal Reserve banks of their respective districts any portion of their reserves now required by section nineteen of this act to be held in their own vaults."

That section thirteen be, and is hereby, amended to read as follows:

"Any Federal Reserve bank may receive from any of its member banks, and from the United States, deposits of current funds in lawful money, national-bank notes, Federal Reserve notes, or checks, and drafts payable upon presentation, and also for collection, maturing bills, or solely for purposes of exchange or of collection, may receive from other Federal Reserve Banks deposits of current funds in lawful money, national-bank notes, or checks upon other Federal Reserve banks, and checks and drafts, payable upon presentation within its district, and maturing bills payable within its district.

"Upon the indorsement of any of its member banks, which shall be deemed a waiver of demand, notice, and protest by such bank as to its own indorsement exclusively, any Federal Reserve bank may discount notes, drafts and bills of exchange arising out of actual commercial transactions, that is, notes, drafts and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes or the proceeds of which have been used, or are to be used, for such purposes, the Federal Reserve Board to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this act. Nothing in this act contained shall be construed to prohibit such notes, drafts, and bills of exchange, secured by staple agricultural products, or other goods, wares, or merchandise from being eligible for such discount, but such definition shall not include notes, drafts, or bills covering merely investments or issued or

drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States. Notes, drafts, and bills admitted to discount under the terms of this paragraph must have a maturity at the time of discount of not more than ninety days, exclusive of days of grace.

“Provided, That notes, drafts, and bills drawn or issued for agricultural purposes or based on live stock and having a maturity not exceeding six months, exclusive of days of grace, may be discounted in an amount to be limited to a percentage of the assets of the federal reserve bank, to be ascertained and fixed by the Federal Reserve Board

“The aggregate of such notes, drafts, and bills bearing the signature or indorsement of any one borrower, whether a person, company, firm, or corporation rediscounted for any one bank shall at no time exceed ten per centum of the unimpaired capital and surplus of said bank, but this restriction shall not apply to the discount of bills of exchange drawn in good faith against actually existing values

“Any federal reserve bank may discount acceptances of the kinds hereinafter described, which have a maturity at the time of discount of not more than three months’ sight exclusive of days of grace, and which are indorsed by at least one member bank

“Any member bank may accept drafts or bills of exchange drawn upon it having not more than six months’ sight to run, exclusive of days of grace, which grow out of transactions involving the importation or exportation of goods, or which grow out of transactions involving the domestic shipment of goods, provided shipping documents conveying or securing title are attached at the time of acceptance, or which are secured at the time of acceptance by a warehouse receipt or other such document conveying or securing title covering readily marketable staples. No member bank shall accept, whether in a foreign or domestic transaction, for any one person, company, firm, or corporation to an amount equal at any time in the aggregate to more than ten per centum of its paid-up and unimpaired capital stock and surplus unless the bank is secured either by attached documents or by some other actual security growing out of the same transaction as the acceptance and no bank shall accept such bills to an amount equal at any time in the aggregate to more than one-half of its paid-up and unimpaired capital stock and surplus

“Any federal reserve bank may make advances to its member banks on their promissory notes for a period not exceeding fifteen days at rates to be established by such federal reserve banks, subject to the review and determination of the Federal Reserve Board, provided such promissory notes are secured by such notes, drafts, bills of exchange, or bankers’ acceptances as are eligible for rediscount or for purchase by federal reserve banks under the provisions of this act, or by the deposit or pledge of bonds or notes of the United States

“Section fifty-two hundred and two of the Revised Statutes of the

United States is hereby amended so as to read as follows No national banking association shall at any time be indebted, or in any way liable, to an amount exceeding the amount of its capital stock at such time actually paid in and remaining undiminished by losses or otherwise, except on account of demands of the nature following

"First Notes of circulation

"Second Moneys deposited with or collected by the association

"Third Bills of exchange or drafts drawn against money actually on deposit to the credit of the association, or due thereto

"Fourth Liabilities to the stockholders of the association for dividends and reserve profits

"Fifth Liabilities incurred under the provisions of the federal reserve act

"The discount and rediscount and the purchase and sale by any federal reserve bank of any bills receivable and of domestic and foreign bills of exchange, and of acceptances authorized by this act, shall be subject to such restrictions, limitations, and regulations as may be imposed by the Federal Reserve Board

"That in addition to the powers now vested by law in national banking associations organized under the laws of the United States any such association located and doing business in any place the population of which does not exceed five thousand inhabitants, as shown by the last preceding decennial census, may, under such rules and regulations as may be prescribed by the Comptroller of the Currency, act as the agent for any fire, life, or other insurance company authorized by the authorities of the State in which said bank is located to do business in said State by soliciting and selling insurance and collecting premiums on policies issued by such company, and may receive for services so rendered such fees or commissions as may be agreed upon between the said association and the insurance company for which it may act as agent, and may also act as the broker or agent for others in making or procuring loans on real estate located within one hundred miles of the place in which said bank may be located, receiving for such services a reasonable fee or commission *Provided, however,* That no such bank shall in any case guarantee either the principal or interest of any such loans or assume or guarantee the payment of any premium on insurance policies issued through its agency by its principal *And provided further,* That the bank shall not guarantee the truth of any statement made by an assured in filing his application for insurance

Any member bank may accept drafts or bills of exchange drawn upon it having not more than three months' sight to run, exclusive of days of grace, drawn under regulations to be prescribed by the Federal Reserve Board by banks or bankers in foreign countries or dependencies or insular possessions of the United States for the purpose of furnishing dollar exchange as required by the usages or trade in the respective countries, dependencies, or insular possessions Such drafts or bills may be acquired

by federal reserve banks in such amounts and subject to such regulations, restrictions, and limitations as may be prescribed by the Federal Reserve Board *Provided, however*, That no member bank shall accept such drafts or bills of exchange referred to in this paragraph for any one bank to an amount exceeding in the aggregate ten per centum of the paid-up and unimpaired capital and surplus of the accepting bank unless the draft or bill of exchange is accompanied by documents conveying or securing title or by some other adequate security *Provided further*, That no member bank shall accept such drafts or bills in an amount exceeding at any time the aggregate of one-half of its paid-up and unimpaired capital and surplus"

That subsection (e) of section fourteen be, and is hereby, amended to read as follows

"(e) To establish accounts with other federal reserve banks for exchange purposes and, with the consent of the Federal Reserve Board, to open and maintain accounts in foreign countries, appoint correspondents, and establish agencies in such countries wheresoever it may deem best for the purpose of purchasing, selling, and collecting bills of exchange, and to buy and sell, with or without its indorsement, through such correspondents or agencies, bills of exchange arising out of actual commercial transactions which have not more than ninety days to run, exclusive of days of grace, and which bear the signature of two or more responsible parties, and with the consent of the Federal Reserve Board to open and maintain banking accounts for such foreign correspondents or agencies"

That the second paragraph of section sixteen be, and is hereby, amended to read as follows

"Any federal reserve bank may make application to the local federal reserve agent for such amount of the federal reserve notes hereinbefore provided for as it may require Such application shall be accompanied with a tender to the local federal reserve agent of collateral in amount equal to the sum of the federal reserve notes thus applied for and issued pursuant to such application The collateral security thus offered shall be notes, drafts, bills of exchange, or acceptances rediscounted under the provisions of section thirteen of this act, or bills of exchange indorsed by a member bank of any Federal Reserve District and purchased under the provisions of section fourteen of this act, or bankers' acceptances purchased under the provisions of said section fourteen, the federal reserve agent shall each day notify the Federal Reserve Board of all issues and withdrawals of federal reserve notes to and by the federal reserve bank to which he is accredited The said Federal Reserve Board may at any time call upon a federal reserve bank for additional security to protect the federal reserve notes issued to it"

That section twenty-four be, and is hereby, amended to read as follows

"SEC 24 Any national banking association not situated in a central reserve city may make loans secured by improved and unencumbered farm land situated within its Federal Reserve District or within a radius of one

hundred miles of the place in which such bank is located, irrespective of district lines, and may also make loans secured by improved and unencumbered real estate located within one hundred miles of the place in which such bank is located, irrespective of district lines, but no loan made upon the security of such farm land shall be made for a longer time than five years, and no loan made upon the security of such real estate as distinguished from farm land shall be made for a longer time than one year nor shall the amount of any such loan, whether upon such farm land or upon such real estate, exceed fifty per centum of the actual value of the property offered as security. Any such bank may make such loans, whether secured by such farm land or such real estate, in an aggregate sum equal to twenty-five per centum of its capital and surplus or to one-third of its time deposits, and such banks may continue hereafter as heretofore to receive time deposits and to pay interest on the same.

"The Federal Reserve Board shall have power from time to time to add to the list of cities in which national banks shall not be permitted to make loans secured upon real estate in the manner described in this section."

That section twenty-five be, and is hereby, amended to read as follows:

"Sec 25 Any national banking association possessing a capital and surplus of \$1,000,000 or more may file application with the Federal Reserve Board for permission to exercise, upon such conditions and under such regulations as may be prescribed by the said Board, either or both of the following powers:

"First To establish branches in foreign countries or dependencies or insular possessions of the United States for the furtherance of the foreign commerce of the United States, and to act if required to do so as fiscal agents of the United States.

"Second To invest an amount not exceeding in the aggregate ten per centum of its paid-in capital stock and surplus in the stock of one or more banks or corporations chartered or incorporated under the laws of the United States or of any State thereof, and principally engaged in international or foreign banking, or banking in dependency or insular possession of the United States either directly or through the agency, ownership, or control of local institutions in foreign countries, or in such dependencies or insular possessions.

"Such application shall specify the name and capital of the banking association filing it, the powers applied for, and the place or places where the banking operations proposed are to be carried on. The Federal Reserve Board shall have power to approve or to reject such application in whole or in part if for any reason the granting of such application is deemed inexpedient, and shall also have power from time to time to increase or decrease the number of places where such banking operations may be carried on.

"Every national banking association operating foreign branches shall be required to furnish information concerning the condition of such branches

to the comptroller of the currency upon demand, and every member bank investing in the capital stock of banks or corporations described under subparagraph two of the first paragraph of this section shall be required to furnish information concerning the condition of such banks or corporations to the Federal Reserve Board upon demand, and the Federal Reserve Board may order special examinations of the said branches, banks, or corporations at such time or times as it may deem best

"Before any national bank shall be permitted to purchase stock in any such corporation the said corporation shall enter into an agreement or undertaking with the Federal Reserve Board to restrict its operations or conduct its business in such manner or under such limitations and restrictions as the said board may prescribe for the place or places wherein such business is to be conducted. If at any time the Federal Reserve Board shall ascertain that the regulations prescribed by it are not being complied with, said Board is hereby authorized and empowered to institute an investigation of the matter and to send for persons and papers, subpoena witnesses, and administer oaths in order to satisfy itself as to the actual nature of the transactions referred to. Should such investigation result in establishing the failure of the corporation in question, or of the national bank or banks which may be stockholders therein, to comply with the regulations laid down by the said Federal Reserve Board, such national banks may be required to dispose of stock holdings in the said corporation upon reasonable notice

"Every such national banking association shall conduct the accounts of each foreign branch independently of the accounts of other foreign branches established by it and of its home office, and shall at the end of each fiscal period transfer to its general ledger the profit or loss accrued at each branch as a separate item

"Any director or other officer, agent, or employee of any member bank may, with the approval of the Federal Reserve Board, be a director or other officer, agent, or employee of any such bank or corporation above mentioned in the capital stock of which such member bank shall have invested as hereinbefore provided, without being subject to the provisions of section eight of the Act approved October fifteenth, nineteen hundred and fourteen, entitled, 'An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes' "

APPENDIX XII

AMENDMENTS TO THE FEDERAL RESERVE ACT RELATING TO ADMISSION OF STATE INSTITUTIONS TO MEMBERSHIP, DEPOSIT OF GOLD AGAINST FEDERAL RESERVE NOTES, RESERVES OF MEMBER BANKS, ETC

(Approved June 21, 1917)

That section three of the act known as the federal reserve act be amended and reenacted so as to read as follows

'SEC 3 The Federal Reserve Board may permit or require any federal reserve bank to establish branch banks within the Federal Reserve District in which it is located or within the district of any federal reserve bank which may have been suspended. Such branches, subject to such rules and regulations as the Federal Reserve Board may prescribe, shall be operated under the supervision of a board of directors to consist of not more than seven nor less than three directors, of whom a majority of one shall be appointed by the federal reserve bank of the district, and the remaining directors by the Federal Reserve Board. Directors of branch banks shall hold office during the pleasure of the Federal Reserve Board.'

SEC 2 That section four in the paragraph relating to the appointment of class C directors and prescribing their duties be amended and reenacted so as to read as follows

"Class C directors shall be appointed by the Federal Reserve Board. They shall have been for at least two years residents of the district for which they are appointed, one of whom shall be designated by said Board as chairman of the board of directors of the federal reserve bank and as 'federal reserve agent'. He shall be a person of tested banking experience, and in addition to his duties as chairman of the board of directors of the federal reserve bank he shall be required to maintain, under regulations to be established by the Federal Reserve Board, a local office of said Board on the premises of the federal reserve bank. He shall make regular reports to the Federal Reserve Board and shall act as its official representative for the performance of the functions conferred upon it by this act. He shall receive an annual compensation to be fixed by the Federal Reserve

Board and paid monthly by the federal reserve bank to which he is designated. One of the directors of class C shall be appointed by the Federal Reserve Board as deputy chairman to exercise the powers of the chairman of the Board when necessary. In case of the absence of the chairman and deputy chairman, the third-class C director shall preside at meetings of the Board.

"Subject to the approval of the Federal Reserve Board, the federal reserve agent shall appoint one or more assistants. Such assistants, who shall be persons of tested banking experience, shall assist the federal reserve agent in the performance of his duties and shall also have power to act in his name and stead during his absence or disability. The Federal Reserve Board shall require such bonds of the assistant federal reserve agents as it may deem necessary for the protection of the United States. Assistants to the federal reserve agent shall receive an annual compensation, to be fixed and paid in the same manner as that of the federal reserve agent."

SEC 3 That section nine be amended and reenacted so as to read as follows:

"SEC 9 Any bank incorporated by special law of any State, or organized under the general laws of any State or of the United States, desiring to become a member of the federal reserve system, may make application to the Federal Reserve Board, under such rules and regulations as it may prescribe, for the right to subscribe to the stock of the federal reserve bank organized within the district in which the applying bank is located. Such application shall be for the same amount of stock that the applying bank would be required to subscribe to as a national bank. The Federal Reserve Board, subject to such conditions as it may prescribe, may permit the applying bank to become a stockholder of such federal reserve bank.

"In acting upon such applications the Federal Reserve Board shall consider the financial condition of the applying bank, the general character of its management, and whether or not the corporate powers exercised are consistent with the purposes of this act.

"Whenever the Federal Reserve Board shall permit the applying bank to become a stockholder in the federal reserve bank of the district its stock subscription shall be payable on call of the Federal Reserve Board, and stock issued to it shall be held subject to the provisions of this act.

"All banks admitted to membership under authority of this section shall be required to comply with the reserve and capital requirements of this act and to conform to those provisions of law imposed on national banks which prohibit such banks from lending on or purchasing their own stock, which relate to the withdrawal or impairment of their capital stock, and which relate to the payment of unearned dividends. Such banks and the officers, agents, and employees thereof shall also be subject to the provisions of and to the penalties prescribed by section fifty-two hundred

and nine of the revised statutes, and shall be required to make reports of condition and of the payment of dividends to the federal reserve bank of which they become a member. Not less than three of such reports shall be made annually on call of the federal reserve bank on dates to be fixed by the Federal Reserve Board. Failure to make such reports within ten days after the date they are called for shall subject the offending bank to a penalty of \$100 a day for each day that it fails to transmit such report, such penalty to be collected by the federal reserve bank by suit or otherwise.

'As a condition of membership such banks shall likewise be subject to examinations made by direction of the Federal Reserve Board or of the federal reserve bank by examiners selected or approved by the Federal Reserve Board.

Whenever the directors of the federal reserve bank shall approve the examinations made by the State authorities, such examinations and the reports thereof may be accepted in lieu of examinations made by examiners selected or approved by the Federal Reserve Board. *Provided, however,* That when it deems it necessary the Board may order special examinations by examiners of its own selection and shall in all cases approve the form of the report. The expenses of all examinations, other than those made by State authorities, shall be assessed against and paid by the banks examined.

'If at any time it shall appear to the Federal Reserve Board that a member bank has failed to comply with the provisions of this section or the regulations of the Federal Reserve Board made pursuant thereto, it shall be within the power of the Board after hearing to require such bank to surrender its stock in the federal reserve bank and to forfeit all rights and privileges of membership. The Federal Reserve Board may restore membership upon due proof of compliance with the conditions imposed by this section.

"Any State bank or trust company desiring to withdraw from membership in a federal reserve bank may do so, after six months' written notice shall have been filed with the Federal Reserve Board, upon the surrender and cancellation of all of its holdings of capital stock in the federal reserve bank. *Provided, however,* That no Federal reserve bank shall except under express authority of the Federal Reserve Board, cancel within the same calendar year more than twenty-five per centum of its capital stock for the purpose of effecting voluntary withdrawals during that year. All such applications shall be dealt with in the order in which they are filed with the Board. Whenever a member bank shall surrender its stock holdings in a federal reserve bank, or shall be ordered to do so by the Federal Reserve Board, under authority of law, all of its rights and privileges as a member bank shall thereupon cease and determine, and after due provision has been made for any indebtedness due or to become due to the federal reserve bank it shall be entitled to a refund of its cash paid sub-

scription with interest at the rate of one-half of one per centum per month from the date of last dividend, if earned, the amount refunded in no event to exceed the book value of the stock at that time, and shall likewise be entitled to repayment of deposits and of any other balance due from the federal reserve bank

"No applying bank shall be admitted to membership in a federal reserve bank unless it possesses a paid-up, unimpaired capital sufficient to entitle it to become a national banking association in the place where it is situated under the provisions of the national-bank act

"Banks becoming members of the federal reserve system under authority of this section shall be subject to the provisions of this section and to those of this act which relate specifically to member banks, but shall not be subject to examination under the provisions of the first two paragraphs of section fifty-two hundred and forty of the revised statutes as amended by section twenty-one of this act Subject to the provisions of this act and to the regulations of the board made pursuant thereto, any bank becoming a member of the federal reserve system shall retain its full charter and statutory rights as a State bank or trust company, and may continue to exercise all corporate powers granted it by the State in which it was created, and shall be entitled to all privileges of member banks *Provided, however,* That no federal reserve bank shall be permitted to discount for any State bank or trust company notes, drafts, or bills of exchange of any one borrower who is liable for borrowed money to such State bank or trust company in an amount greater than ten per centum of the capital and surplus of such State bank or trust company, but the discount of bills of exchange drawn against actually existing value and the discount of commercial or business paper actually owned by the person negotiating the same shall not be considered as borrowed money within the meaning of this section The federal reserve bank, as a condition of the discount of notes, drafts, and bills of exchange for such State bank or trust company, shall require a certificate or guaranty to the effect that the borrower is not liable to such bank in excess of the amount provided by this section, and will not be permitted to become liable in excess of this amount while such notes, drafts, or bills of exchange are under discount with the federal reserve bank

"It shall be unlawful for any officer, clerk, or agent of any bank admitted to membership under authority of this section to certify any check drawn upon such bank unless the person or company drawing the check has on deposit therewith at the time such check is certified an amount of money equal to the amount specified in such check Any check so certified by duly authorized officers shall be a good and valid obligation against such bank, but the act of any such officer, clerk, or agent in violation of this section may subject such bank to a forfeiture of its membership in the federal reserve system upon hearing by the Federal Reserve Board"

SEC 4 That the first paragraph of section thirteen be further amended and reenacted so as to read as follows

"Any federal reserve bank may receive from any of its member banks, and from the United States, deposits of current funds in lawful money, national-bank notes, federal reserve notes, or checks and drafts payable upon presentation, and also, for collection, maturing notes and bills, or, solely for purposes of exchange or of collection, may receive from other federal reserve banks deposits of current funds in lawful money, national-bank notes, or checks upon other federal reserve banks, and checks and drafts payable upon presentation within its district, and maturing notes and bills payable within its district, or, solely for the purposes of exchange or of collection, may receive from any nonmember bank or trust company deposits of current funds in lawful money, national-bank notes, federal reserve notes, checks and drafts payable upon presentation, or maturing notes and bills. *Provided* Such nonmember bank or trust company maintains with the federal reserve bank of its district a balance sufficient to offset the items in transit held for its account by the federal reserve bank. *Provided further*, That nothing in this or any other section of this act shall be construed as prohibiting a member or nonmember bank from making reasonable charges, to be determined and regulated by the Federal Reserve Board but in no case to exceed 10 cents per \$100 or fraction thereof, based on the total of checks and drafts presented at any one time, for collection or payment of checks and drafts and remission therefor by exchange or otherwise, but no such charges shall be made against the federal reserve banks."

SEC 5 That the fifth paragraph of section thirteen be further amended and reenacted so as to read as follows

"Any member bank may accept drafts or bills of exchange drawn upon it having not more than six months sight to run, exclusive of days of grace, which grow out of transactions involving the importation or exportation of goods, or which grow out of transactions involving the domestic shipment of goods provided shipping documents conveying or securing title are attached at the time of acceptance, or which are secured at the time of acceptance by a warehouse receipt or other such document conveying or securing title covering readily marketable staples. No member bank shall accept, whether in a foreign or domestic transaction, for any one person, company, firm, or corporation to an amount equal at any time in the aggregate to more than ten per centum of its paid-up and unimpaired capital stock and surplus, unless the bank is secured either by attached documents or by some other actual security growing out of the same transaction as the acceptance, and no bank shall accept such bills to an amount equal at any time in the aggregate to more than one-half of its paid-up and unimpaired capital stock and surplus. *Provided, however*, That the Federal Reserve Board, under such general regulations as it may prescribe, which shall apply to all banks alike regardless of the amount of capital stock

and surplus, may authorize any member bank to accept such bills to an amount not exceeding at any time in the aggregate one hundred per centum of its paid-up and unimpaired capital stock and surplus *Provided further*, That the aggregate of acceptances growing out of domestic transactions shall in no event exceed fifty per centum of such capital stock and surplus"

SEC 6 That section fourteen, subsection (e), be amended and reenacted so as to read as follows

"(e) To establish accounts with other federal reserve banks for exchange purposes and, with the consent or upon the order and direction of the Federal Reserve Board and under regulations to be prescribed by said Board, to open and maintain accounts in foreign countries, appoint correspondents, and establish agencies in such countries wheresoever it may be deemed best for the purpose of purchasing, selling, and collecting bills of exchange, and to buy and sell, with or without its indorsement, through such correspondents or agencies, bills of exchange (or acceptances) arising out of actual commercial transactions which have not more than ninety days to run, exclusive of days of grace, and which bear the signature of two or more responsible parties, and, with the consent of the Federal Reserve Board, to open and maintain banking accounts for such foreign correspondents or agencies Whenever any such account has been opened or agency or correspondent has been appointed by a federal reserve bank, with the consent of or under the order and direction of the Federal Reserve Board, any other federal reserve bank may, with the consent and approval of the Federal Reserve Board, be permitted to carry on or conduct, through the federal reserve bank opening such account or appointing such agency or correspondent, any transaction authorized by this section under rules and regulations to be prescribed by the Board"

SEC 7 That section sixteen, paragraphs two, three, four, five six, and seven, be further amended and reenacted so as to read as follows

"Any federal reserve bank may make application to the local federal reserve agent for such amount of the federal reserve notes hereinbefore provided for as it may require Such application shall be accompanied with a tender to the local federal reserve agent of collateral in amount equal to the sum of the federal reserve notes thus applied for and issued pursuant to such application The collateral security thus offered shall be notes, drafts, bills of exchange, or acceptances acquired under the provisions of section thirteen of this act, or bills of exchange indorsed by a member bank of any Federal Reserve District and purchased under the provisions of section fourteen of this act, or bankers' acceptances purchased under the provisions of said section fourteen, or gold or gold certificates, but in no event shall such collateral security, whether gold, gold certificates, or eligible paper, be less than the amount of federal reserve notes applied for The federal reserve agent shall each day notify the Federal Reserve Board of all issues and withdrawals of federal reserve notes to and by

the federal reserve bank to which he is accredited. The said Federal Reserve Board may at any time call upon a federal reserve bank for additional security to protect the federal reserve notes issued to it.

Every federal reserve bank shall maintain reserves in gold or lawful money of not less than thirty-five per centum against its deposits and reserves in gold of not less than forty per centum against its federal reserve notes in actual circulation. *Provided, however,* That when the federal reserve agent holds gold or gold certificates as collateral for federal reserve notes issued to the bank such gold or gold certificates shall be counted as part of the gold reserve which such bank is required to maintain against its federal reserve notes in actual circulation. Notes so paid out shall bear upon their faces a distinctive letter and serial number which shall be assigned by the Federal Reserve Board to each federal reserve bank. Whenever federal reserve notes issued through one federal reserve bank shall be received by another federal reserve bank, they shall be promptly returned to credit or redemption to the federal reserve bank through which they were originally issued or, upon direction of such federal reserve bank they shall be forwarded direct to the Treasurer of the United States to be retired. No federal reserve bank shall pay out notes issued through another under penalty of a tax of ten per centum upon the face value of notes so paid out. Notes presented for redemption at the Treasury of the United States shall be paid out of the redemption fund and returned to the federal reserve banks through which they were originally issued, and thereupon such federal reserve bank shall, upon demand of the Secretary of the Treasury, reimburse such redemption fund in lawful money or, if such federal reserve notes have been redeemed by the Treasurer in gold or gold certificates then such funds shall be reimbursed to the extent deemed necessary by the Secretary of the Treasury in gold or gold certificates, and such federal reserve bank shall, so long as any of its federal reserve notes remain outstanding, maintain with the Treasurer in gold an amount sufficient in the judgment of the Secretary to provide for all redemptions to be made by the Treasurer. Federal reserve notes received by the Treasurer otherwise than for redemption may be exchanged for gold out of the redemption fund hereinafter provided and returned to the reserve bank through which they were originally issued, or they may be returned to such bank for the credit of the United States. Federal reserve notes unfit for circulation shall be returned by the federal reserve agents to the comptroller of the currency for cancellation and destruction.

The Federal Reserve Board shall require each federal reserve bank to maintain on deposit in the Treasury of the United States a sum in gold sufficient in the judgment of the Secretary of the Treasury for the redemption of the federal reserve notes issued to such bank, but in no event less than five per centum of the total amount of notes issued less the amount of gold or gold certificates held by the federal reserve agent as collateral security, but such deposit of gold shall be counted and included as part of the forty per centum reserve hereinbefore required.

The Board shall have the right, acting through the federal reserve agent, to grant, in whole or in part, or to reject entirely the application of any federal reserve bank for federal reserve notes, but to the extent that such application may be granted the Federal Reserve Board shall, through its local federal reserve agent, supply federal reserve notes to the banks so applying, and such bank shall be charged with the amount of notes issued to it and shall pay such rate of interest as may be established by the Federal Reserve Board on only that amount of such notes which equals the total amount of its outstanding federal reserve notes less the amount of gold or gold certificates held by the federal reserve agent as collateral security. Federal reserve notes issued to any such bank shall, upon delivery, together with such notes of such federal reserve bank as may be issued under section eighteen of this act upon security of United States two per centum Government bonds, become a first and paramount lien on all the assets of such bank.

"Any federal reserve bank may at any time reduce its liability for outstanding federal reserve notes by depositing with the federal reserve agent its federal reserve notes, gold, gold certificates, or lawful money of the United States. Federal reserve notes so deposited shall not be reissued, except upon compliance with the conditions of an original issue.

"The federal reserve agent shall hold such gold, gold certificates, or lawful money available exclusively for exchange for the outstanding federal reserve notes when offered by the reserve bank of which he is a director. Upon the request of the Secretary of the Treasury the Federal Reserve Board shall require the federal reserve agent to transmit to the Treasurer of the United States so much of the gold held by him as collateral security for federal reserve notes as may be required for the exclusive purpose of the redemption of such federal reserve notes, but such gold when deposited with the Treasurer shall be counted and considered as if collateral security on deposit with the federal reserve agent.

"Any federal reserve bank may at its discretion withdraw collateral deposited with the local federal reserve agent for the protection of its federal reserve notes issued to it and shall at the same time substitute therefor other collateral of equal amount with the approval of the federal reserve agent under regulations to be prescribed by the Federal Reserve Board. Any federal reserve bank may retire any of its federal reserve notes by depositing them with the federal reserve agent or with the Treasurer of the United States, and such federal reserve bank shall thereupon be entitled to receive back the collateral deposited with the federal reserve agent for the security of such notes. Federal reserve banks shall not be required to maintain the reserve or the redemption fund heretofore provided for against federal reserve notes which have been retired. Federal reserve notes so deposited shall not be reissued except upon compliance with the conditions of an original issue."

All federal reserve notes and all gold, gold certificates, and lawful money issued to or deposited with any federal reserve agent under the

provisions of the federal reserve act shall hereafter be held for such agent under such rules and regulations as the Federal Reserve Board may prescribe, in the joint custody of himself and the federal reserve bank to which he is accredited. Such agent and such federal reserve bank shall be jointly liable for the safe-keeping of such federal reserve notes, gold, gold certificates, and lawful money. Nothing herein contained, however, shall be construed to prohibit a federal reserve agent from depositing gold or gold certificates with the Federal Reserve Board, to be held by such board subject to his order or with the Treasurer of the United States for the purposes authorized by law.

SEC 8 That section sixteen be further amended by adding at the end of the section the following

"That the Secretary of the Treasury is hereby authorized and directed to receive deposits of gold coin or of gold certificates with the Treasurer or any assistant treasurer of the United States when tendered by any federal reserve bank or federal reserve agent for credit to its or his account with the Federal Reserve Board. The Secretary shall prescribe by regulation the form of receipt to be issued by the Treasurer or Assistant Treasurer to the federal reserve bank or federal reserve agent making the deposit, and a duplicate of such receipt shall be delivered to the Federal Reserve Board by the Treasurer at Washington upon proper advices from any assistant treasurer that such deposit has been made. Deposits so made shall be held subject to the orders of the Federal Reserve Board and shall be payable in gold coin or gold certificates on the order of the Federal Reserve Board to any federal reserve bank or federal reserve agent at the Treasury or at the Subtreasury of the United States nearest the place of business of such federal reserve bank or such federal reserve agent. *Provided however,* That any expense incurred in shipping gold to or from the Treasury or subtreasuries in order to make such payments, or as a result of making such payments, shall be paid by the Federal Reserve Board and assessed against the federal reserve banks. The order used by the Federal Reserve Board in making such payments shall be signed by the governor or vice governor, or such other officers or members as the board may by regulation prescribe. The form of such order shall be approved by the Secretary of the Treasury.

"The expenses necessarily incurred in carrying out these provisions, including the cost of the certificates or receipts issued for deposits received, and all expenses incident to the handling of such deposits shall be paid by the Federal Reserve Board and included in its assessments against the several federal reserve banks.

'Gold deposits standing to the credit of any federal reserve bank with the Federal Reserve Board shall at the option of said bank, be counted as part of the lawful reserve which it is required to maintain against out-

standing federal reserve notes, or as a part of the reserve it is required to maintain against deposits

"Nothing in this section shall be construed as amending section six of the act of March fourteenth, nineteen hundred, as amended by the acts of March fourth, nineteen hundred and seven, March second, nineteen hundred and eleven, and June twelfth, nineteen hundred and sixteen, nor shall the provisions of this section be construed to apply to the deposits made or to the receipts or certificates issued under those acts"

SEC 9 That section seventeen be amended and reenacted so as to read as follows

"SEC 17 So much of the provisions of section fifty-one hundred and fifty-nine of the Revised Statutes of the United States, and section four of the act of June twentieth, eighteen hundred and seventy-four, and section eight of the act of July twelfth, eighteen hundred and eighty-two, and of any other provisions of existing statutes as require that before any national banking association shall be authorized to commence banking business it shall transfer and deliver to the Treasurer of the United States a stated amount of the United States registered bonds, and so much of those provisions or of any other provisions of existing statutes as require any national banking association now or hereafter organized to maintain a minimum deposit of such bonds with the Treasurer is hereby repealed"

SEC 10 That section nineteen be further amended and reenacted so as to read as follows

"SEC 19 Demand deposits within the meaning of this act shall comprise all deposits payable within thirty days, and time deposits shall comprise all deposits payable after thirty days, all savings accounts and certificates of deposit, which are subject to not less than thirty days' notice before payment, and all postal savings deposits

"Every bank, banking association, or trust company which is or which becomes a member of any federal reserve bank shall establish and maintain reserve balances with its federal reserve bank as follows

"(a) If not in a reserve or central reserve city, as now or hereafter defined, it shall hold and maintain with the federal reserve bank of its district an actual net balance equal to not less than seven per centum of the aggregate amount of its demand deposits and three per centum of its time deposits.

"(b) If in a reserve city, as now or hereafter defined, it shall hold and maintain with the federal reserve bank of its district an actual net balance equal to not less than ten per centum of the aggregate amount of its demand deposits and three per centum of its time deposits

"(c) If in a central reserve city, as now or hereafter defined, it shall hold and maintain with the federal reserve bank of its district an actual net balance equal to not less than thirteen per centum of the aggregate amount of its demand deposits and three per centum of its time deposits

"No member bank shall keep on deposit with any State bank or trust company which is not a member bank a sum in excess of ten per centum of its own paid-up capital and surplus No member bank shall at any a

medium or agent of a nonmember bank in applying for or receiving discounts from a federal reserve bank under the provisions of this act, except by permission of the Federal Reserve Board

"The required balance carried by a member bank with a federal reserve bank may, under the regulations and subject to such penalties as may be prescribed by the Federal Reserve Board, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities. *Provided, however* That no bank shall at any time make new loans or shall pay any dividends unless and until the total balance required by law is fully restored

"In estimating the balances required by this act, the net difference of amounts due to and from other banks shall be taken as the basis for ascertaining the deposits against which required balances with federal reserve banks shall be determined

"National banks, or banks organized under local laws, located in Alaska or in a dependency or insular possession or any part of the United States outside the continental United States may remain nonmember banks, and shall in that event maintain reserves and comply with all the conditions now provided by law regulating them, or said banks may, with the consent of the Reserve Board, become member banks of any one of the Reserve Districts, and shall in that event take stock maintain reserves, and be subject to all the other provisions of this act "

SEC. 11 That that part of section twenty-two which reads as follows "Other than the usual salary or director's fees paid to any officer, director, or employee of a member bank and other than a reasonable fee paid by said bank to such officer, director, or employee for service rendered to such bank, no officer, director, employee, or attorney of a member bank shall be a beneficiary of or receive directly or indirectly any fee, commission, gift, or other consideration for or in connection with any transaction or business of the bank," be amended and re-enacted so as to read as follows

"Other than the usual salary or director's fee paid to any officer, director, employee, or attorney of a member bank, and other than a reasonable fee paid by said bank to such officer, director, employee, or attorney for services rendered to such bank no officer, director, employee, or attorney of a member bank shall be a beneficiary of or receive, directly or indirectly any fee, commission, gift, or other consideration for or in connection with any transaction or business of the bank. *Provided, however,* That nothing in this act contained shall be construed to prohibit a director, officer, employee, or attorney from receiving the same rate of interest paid to other depositors for similar deposits made with such bank. *And provided further,* That notes, drafts bills of exchange, or other evidences of debt executed or indorsed by directors or attorneys of a member bank may be discounted with such member bank on the same terms and condition as other notes, drafts, bills of exchange, or evidences of debt upon the affirmative vote or written assent of at least a majority of the members of the board of directors of such member bank "

APPENDIX XIII

AMENDMENTS TO THE FEDERAL RESERVE ACT RELATING TO TRUST POWERS OF MEMBER BANKS, ETC, AND TO REVISED STATUTES

(Approved September 26, 1918)

That section four of the act approved December twenty-three, nineteen hundred and thirteen, known as the Federal Reserve Act, be amended and reenacted by striking out that part of such section which reads as follows

"Directors of class A and class B shall be chosen in the following manner

"The chairman of the board of directors of the federal reserve bank of the district in which the bank is situated or, pending the appointment of such chairman, the organization committee shall classify the member banks of the district into three general groups or divisions. Each group shall contain as nearly as may be one-third of the aggregate number of the member banks of the district and shall consist, as nearly as may be, of banks of similar capitalization. The groups shall be designated by number by the chairman

"At a regularly called meeting of the board of directors of each member bank in the district it shall elect by ballot a district reserve elector and shall certify his name to the chairman of the board of directors of the federal reserve bank of the district. The chairman shall make lists of the district reserve electors thus named by banks in each of the aforesaid three groups and shall transmit one list to each elector in each group

"Each member bank shall be permitted to nominate to the chairman one candidate for director of class A and one candidate for director of class B. The candidates so nominated shall be listed by the chairman, indicating by whom nominated, and a copy of said list shall, within fifteen days after its completion, be furnished by the chairman to each elector

"Every director shall, within fifteen days after the receipt of the said list, certify to the chairman his first second, and other choices of a director of class A and class B, respectively, upon a preferential ballot, on a form furnished by the chairman of the board of directors of the federal reserve bank of the district. Each elector shall make a cross opposite the name of the first, second, and other choices for a director of class A and for a

director of class B, but shall not vote more than one choice for any one candidate," and by substituting therefor the following

"Directors of class A and class B shall be chosen in the following manner

"The Federal Reserve Board shall classify the member banks of the district into three general groups or divisions, designating each group by number. Each group shall consist as nearly as may be of banks of similar capitalization. Each member bank shall be permitted to nominate to the chairman of the board of directors of the federal reserve bank of the district one candidate for director of class A and one candidate for director of class B. The candidates so nominated shall be listed by the chairman, indicating by whom nominated, and a copy of said list shall, within fifteen days after its completion, be furnished by the chairman to each member bank. Each member bank by a resolution of the Board or by an amendment to its by-laws shall authorize its president, cashier, or some other officer to cast the vote of the member bank in the elections of class A and class B directors.

"Within fifteen days after receipt of the list of candidates the duly authorized officer of a member bank shall return to the chairman his first, second, and other choices for director of class A and class B, respectively, upon a preferential ballot upon a form furnished by the chairman of the board of directors of the federal reserve bank of the district. Each such officer shall make a cross opposite the name of the first, second, and other choices for a director of class A and for a director of class B, but shall not vote more than one choice for any one candidate. No officer or director of a member bank shall be eligible to serve as a class A director unless nominated and elected by banks which are members of the same group as the member bank of which he is an officer or director.

"Any person who is an officer or director of more than one member bank shall not be eligible for nomination as a class A director except by banks in the same group as the bank having the largest aggregate resources of any of those of which such person is an officer or director."

SEC 2 That section eleven (k) of the Federal Reserve Act be amended and reenacted to read as follows

"(k) To grant by special permit to national banks applying therefor, when not in contravention of State or local law, the right to act as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, or in any other fiduciary capacity in which State banks, trust companies, or other corporations which come into competition with national banks are permitted to act under the laws of the State in which the national bank is located.

"Whenever the laws of such State authorize or permit the exercise of any or all of the foregoing powers by State banks, trust companies, or other corporations which compete with national banks, the granting to and

the exercise of such powers by national banks shall not be deemed to be in contravention of State or local law within the meaning of this act

"National banks exercising any or all of the powers enumerated in this subsection shall segregate all assets held in any fiduciary capacity from the general assets of the bank and shall keep a separate set of books and records showing in proper detail all transactions engaged in under authority of this subsection. Such books and records shall be open to inspection by the State authorities to the same extent as the books and records of corporations organized under State law which exercise fiduciary powers, but nothing in this act shall be construed as authorizing the State authorities to examine the books, records, and assets of the national bank which are not held in trust under authority of this subsection

"No national bank shall receive in its trust department deposits of current funds subject to check or the deposit of checks, drafts, bills of exchange, or other items for collection or exchange purposes. Funds deposited or held in trust by the bank awaiting investment shall be carried in a separate account and shall not be used by the bank in the conduct of its business unless it shall first set aside in the trust department United States bonds or other securities approved by the Federal Reserve Board

"In the event of the failure of such bank the owners of the funds held in trust for investment shall have a lien on the bonds or other securities so set apart in addition to their claim against the estate of the bank

"Whenever the laws of a State require corporations acting in a fiduciary capacity to deposit securities with the State authorities for the protection of private or court trusts, national banks so acting shall be required to make similar deposits and securities so deposited shall be held for the protection of private or court trusts, as provided by the State law

"National banks in such cases shall not be required to execute the bond usually required of individuals if State corporations under similar circumstances are exempt from this requirement

"National banks shall have power to execute such bond when so required by the laws of the State

"In any case in which the laws of a State require that a corporation acting as trustee, executor, administrator, or in any capacity specified in this section shall take an oath or make an affidavit, the president, vice president, cashier, or trust officer of such national bank may take the necessary oath or execute the necessary affidavit

"It shall be unlawful for any national banking association to lend any officer, director, or employee any funds held in trust under the powers conferred by this section. Any officer, director, or employee making such loan, or to whom such loan is made, may be fined not more than \$5,000, or imprisoned not more than five years, or may be both fined and imprisoned, in the discretion of the court

"In passing upon applications for permission to exercise the powers enumerated in this subsection, the Federal Reserve Board may take into consideration the amount of capital and surplus of the applying bank, whether

or not such capital and surplus is sufficient under the circumstances of the case, the needs of the community to be served, and any other facts and circumstances that seem to it proper, and may grant or refuse the application accordingly *Provided*, That no permit shall be issued to any national banking association having a capital and surplus less than the capital and surplus required by State law of State banks, trust companies, and corporations exercising such powers "

SEC 3 That the ninth paragraph of section sixteen of the Federal Reserve Act, as amended by the acts approved September seventh, nineteen hundred and sixteen, and June twenty-first, nineteen hundred and seventeen, be further amended and reenacted so as to read as follows

"In order to furnish suitable notes for circulation as Federal reserve notes, the Comptroller of the Currency shall, under the direction of the Secretary of the Treasury cause plates and dies to be engraved in the best manner to guard against counterfeits and fraudulent alterations, and shall have printed therefrom and numbered such quantities of such notes of the denominations of \$5, \$10, \$20, \$50, \$100, \$500, \$1,000, \$5,000, \$10,000 as may be required to supply the Federal Reserve Banks. Such notes shall be in form and tenor as directed by the Secretary of the Treasury under the provisions of this act and shall bear the distinctive numbers of the several Federal Reserve Banks through which they are issued "

SEC 4 That paragraphs (b) and (c) of section nineteen of the Federal Reserve Act, as amended by the acts approved August fifteenth, nineteen hundred and fourteen, and June twenty-first, nineteen hundred and seventeen, be further amended and reenacted to read as follows

"(b) If in a reserve city as now or hereafter defined, it shall hold and maintain with the Federal Reserve Bank of its district an actual net balance equal to not less than ten per centum of the aggregate amount of its demand deposits and three per centum of its time deposits. *Provided, however*, That if located in the outlying districts of a reserve city or in territory added to such a city by the extension of its corporate charter, it may, upon the affirmative vote of five members of the Federal Reserve Board, hold and maintain the reserve balances specified in paragraph (a) hereof

"(c) If in a central reserve city as now or hereafter defined, it shall hold and maintain with the Federal Reserve Bank of its district an actual net balance equal to not less than thirteen per centum of the aggregate amount of its demand deposits and three per centum of its time deposits. *Provided, however*, That if located in the outlying districts of a central reserve city or in territory added to such city by the extension of its corporate charter, it may, upon the affirmative vote of five members of the Federal Reserve Board, hold and maintain the reserve balances specified in paragraphs (a) or (b) thereof "

SEC 5 That section twenty-two of the Federal Reserve act, as amended by the act of June twenty-first, nineteen hundred and seventeen, be further amended and reenacted to read as follows

"(a) No member bank and no officer, director, or employee thereof shall hereafter make any loan or grant any gratuity to any bank examiner. Any bank officer, director, or employee violating this provision shall be deemed guilty of a misdemeanor and shall be imprisoned not exceeding one year or fined not more than \$5,000, or both, and may be fined a further sum equal to the money so loaned or gratuity given.

"Any examiner accepting a loan or gratuity from any bank examined by him or from an officer, director, or employee thereof, shall be deemed guilty of a misdemeanor and shall be imprisoned one year or fined not more than \$5,000, or both, and may be fined a further sum equal to the money so loaned or gratuity given, and shall forever thereafter be disqualified from holding office as a national bank examiner.

"(b) No national bank examiner shall perform any other service for compensation while holding such office for any bank or officer, director, or employee thereof.

"No examiner, public or private, shall disclose the names of borrowers or the collateral for loans of a member bank to other than the proper officers of such bank without first having obtained the express permission in writing from the Comptroller of the Currency, or from the board of directors of such bank, except when ordered to do so by a court of competent jurisdiction, or by direction of the Congress of the United States, or of either House thereof, or any committee of Congress or of either House duly authorized. Any bank examiner violating the provisions of this subsection shall be imprisoned not more than one year or fined not more than \$5,000, or both.

"(c) Except as herein provided, any officer, director, employee, or attorney of a member bank who stipulates for or receives or consents or agrees to receive any fee, commission, gift, or thing of value from any person, firm, or corporation for procuring or endeavoring to procure for such person, firm, or corporation, or for any other person, firm, or corporation, any loan from or the purchase or discount of any paper, note, draft, check, or bill of exchange by such member bank shall be deemed guilty of a misdemeanor and shall be imprisoned not more than one year or fined not more than \$5,000, or both.

"(d) Any member bank may contract for, or purchase from, any of its directors or from any firm of which any of its directors is a member, any securities or other property, when (and not otherwise) such purchase is made in the regular course of business upon terms not less favorable to the bank than those offered to others, or when such purchase is authorized by a majority of the board of directors not interested in the sale of such securities or property, such authority to be evidenced by the affirmative vote or written assent of such directors. *Provided, however,* That when any director, or firm of which any director is a member, acting for or on behalf of others, sells securities or other property to a member bank, the Federal Reserve Board by regulation may, in any or all cases, require a full disclosure to be made, on forms to be prescribed by it, of all commissions or

other considerations received, and whenever such director or firm, acting in his or its own behalf, sells securities or other property to the bank the Federal Reserve Board, by regulation, may require a full disclosure of all profits realized from such sale

"Any member bank may sell securities or other property to any of its directors, or to a firm of which any of its directors is a member, in the regular course of business on terms not more favorable to such director or firm than those offered to others, or when such sale is authorized by a majority of the board of directors of a member bank to be evidenced by their affirmative vote or written assent. *Provided however:* That nothing in this subsection contained shall be construed as authorizing member banks to purchase or sell securities or other property which such banks are not otherwise authorized by law to purchase or sell

"(e) No member bank shall pay to any director, officer, attorney, or employee a greater rate of interest on the deposits of such director, officer, attorney or employee than that paid to other depositors on similar deposits with such member bank

"(f) If the directors or officers of any member bank shall knowingly violate or permit any of the agents, officers, or directors of any member bank to violate any of the provisions of this section or regulations of the board made under authority thereof every director and officer participating in or assenting to such violation shall be held liable in his personal and individual capacity for all damages which the member bank, its shareholders or any other persons shall have sustained in consequence of such violation "

SEC 7 That section fifty-two hundred and eight of the Revised Statutes as amended by the act of July twelfth, eighteen hundred and eighty-two, and section fifty-two hundred and nine of the Revised Statutes as amended by the acts of April sixth, eighteen hundred and sixty-nine and July eighth, eighteen hundred and seventy, be and the same are hereby, amended and reenacted to read as follows

"SEC 5208 It shall be unlawful for any officer, director, agent, or employee of any Federal Reserve Bank or of any member bank as defined in the act of December twenty-third, nineteen hundred and thirteen, known as the Federal Reserve Act to certify any check drawn upon such Federal Reserve Bank or member bank unless the person, firm or corporation drawing the check has on deposit with such Federal Reserve Bank or member bank, at the time such check is certified, an amount of money not less than the amount specified in such check. Any check so certified by a duly authorized officer, director, agent, or employee shall be a good and valid obligation against such Federal Reserve Bank or member bank, but the act of any officer, director, agent or employee of any such Federal Reserve Bank or member bank in violation of this section shall, in the discretion of the Federal Reserve Board, subject such Federal Reserve Bank to the penalties imposed by section eleven, subsection (h), of the Federal Reserve Act, and shall subject such member bank if a national bank to the liabilities and proceedings on the part of the Comptroller of

the Currency provided for in section fifty-two hundred and thirty-four, Revised Statutes, and shall, in the discretion of the Federal Reserve Board, subject any other member bank to the penalties imposed by section nine of said Federal Reserve Act for the violation of any of the provisions of said act. Any officer, director, agent, or employee of any Federal Reserve Bank or member bank who shall willfully violate the provisions of this section, or who shall resort to any device, or receive any fictitious obligation, directly or collaterally, in order to evade the provisions thereof, or who shall certify a check before the amount thereof shall have been regularly entered to the credit of the drawer upon the books of the bank, shall be deemed guilty of a misdemeanor and shall, on conviction thereof in any district court of the United States, be fined not more than \$5,000, or shall be imprisoned for not more than five years, or both, in the discretion of the court.

"Sec 5209 Any officer, director, agent, or employee of any Federal Reserve Bank, or of any member bank as defined in the act of December twenty-third, nineteen hundred and thirteen, known as the Federal Reserve Act, who embezzles, abstracts, or willfully misapplies any of the moneys, funds, or credits of such Federal Reserve Bank or member bank, or who, without authority from the directors of such Federal Reserve Bank or member bank, issues or puts in circulation any of the notes of such Federal reserve bank or member bank, or who, without such authority, issues or puts forth any certificate of deposit, draws any order or bill of exchange, makes any acceptance, assigns any note, bond, draft, bill of exchange, mortgage, judgment, or decree, or who makes any false entry in any book, report, or statement of such Federal Reserve Bank or member bank, with intent in any case to injure or defraud such Federal Reserve Bank or member bank, or any other company, body politic or corporate, or any individual person, or to deceive any officer of such Federal Reserve Bank or member bank, or the Comptroller of the Currency, or any agent or examiner appointed to examine the affairs of such Federal Reserve Bank or member bank, or the Federal Reserve Board, and every receiver of a national banking association who, with like intent to defraud or injure, embezzles, abstracts, purloins, or willfully misapplies any of the moneys, funds, or assets of his trust, and every person who, with like intent, aids or abets any officer, director, agent, employee, or receiver in any violation of this section shall be deemed guilty of a misdemeanor, and upon conviction thereof in any district court of the United States shall be fined not more than \$5,000 or shall be imprisoned for not more than five years, or both, in the discretion of the court.

"Any Federal Reserve Agent, or any agent or employee of such Federal Reserve Agent, or of the Federal Reserve Board, who embezzles, abstracts, or willfully misapplies any moneys, funds, or securities intrusted to his care, or without complying with or in violation of the provisions of the Federal Reserve Act, issues or puts in circulation any Federal Reserve notes shall be guilty of a misdemeanor and upon conviction in any district court of the United States shall be fined not more than \$5,000 or imprisoned for not more than five years, or both, in the discretion of the court."

APPENDIX XIV

AMENDMENTS TO THE FEDERAL RESERVE ACT AND REVISED STATUTES OF THE UNITED STATES.

(Approved March 3, 1919)

That that part of the first paragraph of section seven of the Federal Reserve Act which reads as follows: "After the aforesaid dividend claims have been fully met, all the net earnings shall be paid to the United States as a franchise tax except that one-half of such net earnings shall be paid into a surplus fund until it shall amount to forty per centum of the paid-in capital stock of such bank," be amended to read as follows:

"After the aforesaid dividend claims have been fully met, the net earnings shall be paid to the United States as a franchise tax except that the whole of such net earnings, including those for the year ending December thirty-first, nineteen hundred and eighteen, shall be paid into a surplus fund until it shall amount to one hundred per centum of the subscribed capital stock of such bank, and that thereafter ten per centum of such net earnings shall be paid into the surplus."

SEC. 2. That that part of section ten of the Federal Reserve Act which reads as follows: "The members of said board, the Secretary of the Treasury, the Assistant Secretaries of the Treasury, and the Comptroller of the Currency, shall be ineligible during the time they are in office and for two years thereafter to hold any office, position, or employment in any member bank," be amended to read as follows:

"The Secretary of the Treasury and the Comptroller of the Currency shall be ineligible during the time they are in office and for two years thereafter to hold any office, position, or employment in any member bank. The appointive members of the Federal Reserve Board shall be ineligible during the time they are in office and for two years thereafter to hold any office, position, or employment in any member bank, except that this restriction shall not apply to a member who has served the full term for which he was appointed."

SEC. 3. That section eleven of the Federal Reserve Act as amended by the Act of September seventh, nineteen hundred and sixteen, be further

amended by striking out the whole of subsection (m) and by substituting therefore a subsection to read as follows

"(m) Upon the affirmative vote of not less than five of its members, the Federal Reserve Board shall have power to permit Federal reserve banks to discount for any member bank notes, drafts, or bills of exchange bearing the signature or endorsement of any one borrower in excess of the amount permitted by section nine and section thirteen of this Act, but in no case to exceed twenty per centum of the member bank's capital and surplus *Provided, however*, That all such notes, drafts, or bills of exchange discounted for any member bank in excess of the amount permitted under such sections shall be secured by not less than a like face amount of bonds or notes of the United States issued since April twenty-fourth, nineteen hundred and seventeen, or certificates of indebtedness of the United States *Provided further*, That the provisions of this subsection (m) shall not be operative after December thirty-first, nineteen hundred and twenty"

SEC 4 That section fifty-one hundred and seventy-two, Revised Statutes of the United States, be amended to read as follows

"SEC 5172 That in order to furnish suitable notes for circulation, the Comptroller of the Currency shall, under the direction of the Secretary of the Treasury, cause plates and dies to be engraved, in the best manner to guard against counterfeiting and fraudulent alterations, and shall have printed therefrom and numbered such quantity of circulating notes in blank, or bearing engraved signatures of officers as herein provided, of the denominations of \$1, \$2, \$5, \$10, \$20, \$50, \$100, \$500 and \$1,000, as may be required to supply the associations entitled to receive the same. Such notes shall express upon their face that they are secured by United States bonds deposited with the Treasurer of the United States, by the written or engraved signatures of the Treasurer and Register, and by the imprint of the seal of the Treasury, and shall also express upon their face the promise of the association receiving the same to pay on demand, attested by the written or engraved signatures of the president or vice president and cashier, and shall bear such devices and such other statements and shall be in such form as the Secretary of the Treasury shall, by regulation, direct"

APPENDIX XV

AMENDMENTS TO THE FEDERAL RESERVE ACT

(Approved September 17, 1919)

That section 25 of the Act approved December 23, 1913, known as the Federal Reserve Act, as amended by the Act approved September 7, 1916, be further amended by the addition of the following paragraph at the end of subparagraph 2 of the first paragraph, after the word "possessions":

"Until January 1, 1921, any national banking association, without regard to the amount of its capital and surplus, may file application with the Federal Reserve Board for permission, upon such conditions and under such regulations as may be prescribed by said board, to invest an amount not exceeding in the aggregate 5 per centum of its paid-in capital and surplus in the stock of one or more corporations chartered or incorporated under the laws of the United States or of any State thereof and, regardless of its location, principally engaged in such phases of international or foreign financial operations as may be necessary to facilitate the export of goods, wares, or merchandise from the United States or any of its dependencies or insular possessions to any foreign country: *Provided, however,* That in no event shall the total investments authorized by this section by any one national bank exceed 10 per centum of its capital and surplus."

SEC. 2. That paragraph 2 of said section be amended by adding after the word "banking," in line three, the words "or financial," so that the sentence will read: "Such application shall specify the name and capital of the banking association filing it, the powers applied for, and the place or places where the banking or financial operations proposed are to be carried on."

SEC. 3. That paragraph 3 of said section be amended by striking out the words "subparagraph 2 of the first paragraph of this section" and inserting in lieu thereof the words "above," so that the paragraph will read:

"Every national banking association operating foreign branches shall be required to furnish information concerning the condition of such branches to the Comptroller of the Currency upon demand, and every member bank investing in the capital stock of banks or corporations described above shall be required to furnish information concerning the condition of such banks or corporations to the Federal Reserve Board upon demand, and the Federal Reserve Board may order special examinations of the said branches, banks, or corporations at such time or times as it may deem best."

APPENDIX XVI

AMENDMENT TO THE FEDERAL RESERVE ACT AUTHORIZING FORMATION OF THE SO- CALLED EDGE LAW BANKS

(Approved December 24, 1919)

That the Act approved December 23, 1913, known as the Federal Reserve Act, as amended, be further amended by adding a new section as follows

"BANKING CORPORATIONS AUTHORIZED TO DO FOREIGN BANKING BUSINESS

"SEC 25 (a) Corporations to be organized for the purpose of engaging in international or foreign banking or other international or foreign financial operations, or in banking or other financial operations in a dependency or insular possession of the United States, either directly or through the agency, ownership, or control of local institutions in foreign countries, or in such dependencies or insular possessions as provided by this section, and to act when required by the Secretary of the Treasury as fiscal agents of the United States, may be formed by any number of natural persons, not less in any case than five

"Such persons shall enter into articles of association which shall specify in general terms the objects for which the association is formed and may contain any other provisions not inconsistent with law which the association may see fit to adopt for the regulation of its business and the conduct of its affairs

"Such articles of association shall be signed by all of the persons intending to participate in the organization of the corporation and, thereafter, shall be forwarded to the Federal Reserve Board and shall be filed and preserved in its office. The persons signing the said articles of association shall, under their hands, make an organization certificate which shall specifically state

"First The name assumed by such corporation, which shall be subject to the approval of the Federal Reserve Board

"Second The place or places where its operations are to be carried on

"Third The place in the United States where its home office is to be located

"Fourth The amount of its capital stock and the number of shares into which the same shall be divided

"Fifth The names and places of business or residence of the persons executing the certificate and the number of shares to which each has subscribed

"Sixth The fact that the certificate is made to enable the persons subscribing the same, and all other persons, firms, companies, and corporations, who or which may thereafter subscribe to or purchase shares of the capital stock of such corporation, to avail themselves of the advantages of this section

"The persons signing the organization certificate shall duly acknowledge the execution thereof before a judge of some court of record or notary public, who shall certify thereto under the seal of such court or notary, and thereafter the certificate shall be forwarded to the Federal Reserve Board to be filed and preserved in its office Upon duly making and filing articles of association and an organization certificate, and after the Federal Reserve Board has approved the same and issued a permit to begin business, the association shall become and be a body corporate, and as such and in the name designated therein shall have power to adopt and use a corporate seal, which may be changed at the pleasure of its board of directors, to have succession for a period of twenty years unless sooner dissolved by the act of the shareholders owning two-thirds of the stock or by an Act of Congress or unless its franchise become forfeited by some violation of law, to make contracts, to sue and be sued, complain, and defend in any court of law or equity, to elect or appoint directors, all of whom shall be citizens of the United States, and, by its board of directors, to appoint such officers and employees as may be deemed proper, define their authority and duties, require bonds of them, and fix the penalty thereof, dismiss such officers or employees, or any thereof, at pleasure and appoint others to fill their places, to prescribe, by its board of directors, by-laws not inconsistent with law or with the regulations of the Federal Reserve Board regulating the manner in which its stock shall be transferred, its directors elected or appointed, its officers and employees appointed, its property transferred, and the privileges granted to it by law exercised and enjoyed

"Each corporation so organized shall have power, under such rules and regulations as the Federal Reserve Board may prescribe

"(a) To purchase, sell, discount, and negotiate, with or without its indorsement or guaranty, notes, drafts, checks, bills of exchange, acceptances, including bankers' acceptances, cable transfers, and other evidences of indebtedness, to purchase and sell, with or without its indorsement or guaranty, securities, including the obligations of the United States or of any State thereof but not including shares of stock in any corporation except as herein provided, to accept bills or drafts drawn upon it subject to such

limitations and restrictions as the Federal Reserve Board may impose, to issue letters of credit, to purchase and sell coin, bullion, and exchange, to borrow and to lend money, to issue debentures, bonds, and promissory notes under such general conditions as to security and such limitations as the Federal Reserve Board may prescribe, but in no event having liabilities outstanding thereon at any one time exceeding ten times its capital stock and surplus, to receive deposits outside of the United States and to receive only such deposits within the United States as may be incidental to or for the purpose of carrying out transactions in foreign countries or dependencies or insular possessions of the United States, and generally to exercise such powers as are incidental to the powers conferred by this Act or as may be usual, in the determination of the Federal Reserve Board, in connection with the transaction of the business of banking or other financial operations in the countries, colonies, dependencies, or possessions in which it shall transact business and not inconsistent with the powers specially granted herein. Nothing contained in this section shall be construed to prohibit the Federal Reserve Board, under its power to prescribe rules and regulations, from limiting the aggregate amount of liabilities of any or all classes incurred by the corporation and outstanding at any one time. Whenever a corporation organized under this section receives deposits in the United States authorized by this section it shall carry reserves in such amounts as the Federal Reserve Board may prescribe, but in no event less than 10 per centum of its deposits.

"(b) To establish and maintain for the transaction of its business branches or agencies in foreign countries, their dependencies or colonies, and in the dependencies or insular possessions of the United States, at such places as may be approved by the Federal Reserve Board and under such rules and regulations as it may prescribe, including countries or dependencies not specified in the original organization certificate

"(c) With the consent of the Federal Reserve Board to purchase and hold stock or other certificates of ownership in any other corporation organized under the provisions of this section, or under the laws of any foreign country or a colony or dependency thereof, or under the laws of any State, dependency, or insular possession of the United States but not engaged in the general business of buying or selling goods, wares, merchandise or commodities in the United States, and not transacting any business in the United States except such as in the judgment of the Federal Reserve Board may be incidental to its international or foreign business. *Provided, however,* That, except with the approval of the Federal Reserve Board, no corporation organized hereunder shall invest in any one corporation an amount in excess of 10 per centum of its own capital and surplus, except in a corporation engaged in the business of banking, when 15 per centum of its capital and surplus may be so invested. *Provided further,* That no corporation organized hereunder shall purchase, own, or hold stock or certificates of ownership in any other corporation organized hereunder or under

the laws of any State which is in substantial competition therewith, or which holds stock or certificates of ownership in corporations which are in substantial competition with the purchasing corporation

"Nothing contained herein shall prevent corporations organized hereunder from purchasing and holding stock in any corporation where such purchase shall be necessary to prevent a loss upon a debt previously contracted in good faith, and stock so purchased or acquired in corporations organized under this section shall within six months from such purchase be sold or disposed of at public or private sale unless the time to so dispose of same is extended by the Federal Reserve Board

"No corporation organized under this section shall carry on any part of its business in the United States except such as, in the judgment of the Federal Reserve Board, shall be incidental to its international or foreign business *And provided further*, That except such as is incidental and preliminary to its organization no such corporation shall exercise any of the powers conferred by this section until it has been duly authorized by the Federal Reserve Board to commence business as a corporation organized under the provisions of this section

"No corporation organized under this section shall engage in commerce or trade in commodities except as specifically provided in this section, nor shall it either directly or indirectly control or fix or attempt to control or fix the price of any such commodities. The charter of any corporation violating this provision shall be subject to forfeiture in the manner hereinafter provided in this section. It shall be unlawful for any director, officer, agent, or employee of any such corporation to use or to conspire to use the credit, the funds, or the power of the corporation to fix or control the price of any such commodities, and any such person violating this provision shall be liable to a fine of not less than \$1,000 and not exceeding \$5,000 or imprisonment not less than one year and not exceeding five years, or both, in the discretion of the court

"No corporation shall be organized under the provisions of this section with a capital stock of less than \$2,000,000, one-quarter of which must be paid in before the corporation may be authorized to begin business, and the remainder of the capital stock of such corporation shall be paid in installments of at least 10 per centum on the whole amount to which the corporation shall be limited as frequently as one installment at the end of each succeeding two months from the time of the commencement of its business operations until the whole of the capital stock shall be paid in. The capital stock of any such corporation may be increased at any time, with the approval of the Federal Reserve Board, by a vote of two-thirds of its shareholders or by unanimous consent in writing of the shareholders without a meeting and without a formal vote, but any such increase of capital shall be fully paid in within ninety days after such approval, and may be reduced in like manner, provided that in no event shall it be less than \$2,000,000. No corporation, except as herein provided, shall during

the time it shall continue its operations withdraw or permit to be withdrawn, either in the form of dividends or otherwise, any portion of its capital. Any national banking association may invest in the stock of any corporation organized under the provisions of this section, but the aggregate amount of stock held in all corporations engaged in business of the kind described in this section and in section 25 of the Federal Reserve Act as amended shall not exceed 10 per centum of the subscribing bank's capital and surplus.

"A majority of the shares of the capital stock of any such corporation shall at all times be held and owned by citizens of the United States, by corporations the controlling interest in which is owned by citizens of the United States, chartered under the laws of the United States or of a State of the United States, or by firms or companies, the controlling interest in which is owned by citizens of the United States. The provisions of section 8 of the act approved October 15, 1914, entitled 'An act to supplement existing laws against unlawful restraints and monopolies, and for other purposes,' as amended by the acts of May 15, 1916 and September 7, 1916, shall be construed to apply to the directors, other officers, agents, or employees of corporations organized under the provisions of this section. *Provided, however,* That nothing herein contained shall (1) prohibit any director or other officer, agent or employee of any member bank, who has procured the approval of the Federal Reserve Board from serving at the same time as a director or other officer, agent or employee of any corporation organized under the provisions of this section in whose capital stock such member bank shall have invested, or (2) prohibit any director or other officer, agent or employee of any corporation organized under the provisions of this section, who has procured the approval of the Federal Reserve Board, from serving at the same time as a director or other officer, agent or employee of any other corporation in whose capital stock such first-mentioned corporation shall have invested under the provisions of this section.

"No member of the Federal Reserve Board shall be an officer or director of any corporation organized under the provisions of this section, or of any corporation engaged in similar business organized under the laws of any State, nor hold stock in any such corporation, and before entering upon his duties as a member of the Federal Reserve Board he shall certify under oath to the Secretary of the Treasury that he has complied with this requirement.

"Shareholders in any corporation organized under the provisions of this section shall be liable for the amount of their unpaid stock subscriptions. No such corporation shall become a member of any Federal reserve bank.

"Should any corporation organized hereunder violate or fail to comply with any of the provisions of this section, all of its rights, privileges, and franchises derived herefrom may thereby be forfeited. Before any such corporation shall be declared dissolved, or its rights, privileges, and franchises forfeited, any noncompliance with, or violation of such laws shall, however, be determined and adjudged by a court of the United States of

competent jurisdiction, in a suit brought for that purpose in the district or territory in which the home office of such corporation is located, which suit shall be brought by the United States at the instance of the Federal Reserve Board or the Attorney General. Upon adjudication of such non-compliance or violation, each director and officer who participated in, or assented to, the illegal act or acts, shall be liable in his personal or individual capacity for all damages which the said corporation shall have sustained in consequence thereof. No dissolution shall take away or impair any remedy against the corporation, its stockholders, or officers for any liability or penalty previously incurred.

"Any such corporation may go into voluntary liquidation and be closed by a vote of its shareholders owning two-thirds of its stock.

"Whenever the Federal Reserve Board shall become satisfied of the insolvency of any such corporation, it may appoint a receiver who shall take possession of all of the property and assets of the corporation and exercise the same rights, privileges, powers, and authority with respect thereto as are now exercised by receivers of national banks appointed by the Comptroller of the Currency of the United States. *Provided, however,* That the assets of the corporation subject to the laws of other countries or jurisdictions shall be dealt with in accordance with the terms of such laws.

"Every corporation organized under the provisions of this section shall hold a meeting of its stockholders annually upon a date fixed in its by-laws such meeting to be held at its home office in the United States. Every such corporation shall keep at its home office books containing the names of all stockholders thereof, and the names and addresses of the members of its board of directors, together with copies of all reports made by it to the Federal Reserve Board. Every such corporation shall make reports to the Federal Reserve Board at such times and in such form as it may require, and shall be subject to examination once a year and at such other times as may be deemed necessary by the Federal Reserve Board by examiners appointed by the Federal Reserve Board, the cost of such examinations, including the compensation of the examiners, to be fixed by the Federal Reserve Board and to be paid by the corporation examined.

"The directors of any corporation organized under the provisions of this section may, semiannually, declare a dividend of so much of the net profits of the corporation as they shall judge expedient, but each corporation shall, before the declaration of a dividend, carry one-tenth of its net profits of the preceding half year to its surplus fund until the same shall amount to 20 per centum of its capital stock.

"Any corporation organized under the provisions of this section shall be subject to tax by the State within which its home office is located in the same manner and to the same extent as other corporations organized under the laws of that State which are transacting a similar character of business. The shares of stock in such corporation shall also be subject

to tax as the personal property of the owners or holders thereof in the same manner and to the same extent as the shares of stock in similar State corporations

"Any corporation organized under the provisions of this section may at any time within the two years next previous to the date of the expiration of its corporate existence, by a vote of the shareholders owning two-thirds of its stock, apply to the Federal Reserve Board for its approval to extend the period of its corporate existence for a term of not more than twenty years, and upon certified approval of the Federal Reserve Board such corporation shall have its corporate existence for such extended period unless sooner dissolved by the act of the shareholders owning two-thirds of its stock, or by an Act of Congress or unless its franchise becomes forfeited by some violation of law

"Any bank or banking institution, principally engaged in foreign business, incorporated by special law of any State or of the United States or organized under the general laws of any State or of the United States and having an unimpaired capital sufficient to entitle it to become a corporation under the provisions of this section may, by the vote of the shareholders owning not less than two-thirds of the capital stock of such bank or banking association, with the approval of the Federal Reserve Board, be converted into a Federal corporation of the kind authorized by this section with any name approved by the Federal Reserve Board *Provided, however,* That said conversion shall not be in contravention of the State law. In such case the articles of association and organization certificate may be executed by a majority of the directors of the bank or banking institution, and the certificate shall declare that the owners of at least two-thirds of the capital stock have authorized the directors to make such certificate and to change or convert the bank or banking institution into a Federal corporation. A majority of the directors, after executing the articles of association and the organization certificate, shall have power to execute all other papers and do whatever may be required to make its organization perfect and complete as a Federal corporation. The shares of any such corporation may continue to be for the same amount each as they were before the conversion, and the directors may continue to be directors of the corporation until others are elected or appointed in accordance with the provisions of this section. When the Federal Reserve Board has given to such corporation a certificate that the provisions of this section have been complied with, such corporation and all its stockholders, officers, and employees, shall have the same powers and privileges, and shall be subject to the same duties, liabilities, and regulations, in all respects, as shall have been prescribed by this section for corporations originally organized hereunder

"Every officer, director, clerk, employee, or agent of any corporation organized under this section who embezzles, abstracts, or willfully misapplies any of the moneys, funds, credits, securities, evidences of indebtedness or assets of any character of such corporation, or who, without authority

from the directors, issues or puts forth any certificate of deposit, draws any order or bill of exchange, makes any acceptance, assigns any note, bond, debenture, draft, bill of exchange, mortgage, judgment, or decree, or who makes any false entry in any book, report, or statement of such corporation with intent, in either case, to injure or defraud such corporation or any other company, body politic or corporate, or any individual person, or to deceive any officer of such corporation, the Federal Reserve Board, or any agent or examiner appointed to examine the affairs of any such corporation, and every receiver of any such corporation and every clerk or employee of such receiver who shall embezzle, abstract, or willfully misapply or wrongfully convert to his own use any moneys, funds, credits, or assets of any character which may come into his possession or under his control in the execution of his trust or the performance of the duties of his employment, and every such receiver or clerk or employee of such receiver who shall, with intent to injure or defraud any person, body politic or corporate, or to deceive or mislead the Federal Reserve Board, or any agent or examiner appointed to examine the affairs of such receiver shall make any false entry in any book, report, or record of any matter connected with the duties of such receiver, and every person who with like intent aids or abets any officer, director, clerk, employee, or agent of any corporation organized under this section, or receiver or clerk or employee of such receiver as aforesaid in any violation of this section, shall upon conviction thereof be imprisoned for not less than two years nor more than ten years, and may also be fined not more than \$5,000, in the discretion of the court

"Whoever being connected in any capacity with any corporation organized under this section represents in any way that the United States is liable for the payment of any bond or other obligation, or the interest thereon, issued or incurred by any corporation organized hereunder, or that the United States incurs any liability in respect of any act or omission of the corporation, shall be punished by a fine of not more than \$10,000 and by imprisonment for not more than five years"

APPENDIX XVII

AMENDMENT TO THE FEDERAL RESERVE ACT

(Approved April 13, 1920)

That section 14 of the Federal Reserve Act as amended by the Acts approved September 7, 1916, and June 21, 1917, be further amended by striking out the semicolon after the word "business" at the end of subparagraph (d) and insert in lieu thereof the following "and which, subject to the approval, review, and determination of the Federal Reserve Board, may be graduated or progressed on the basis of the amount of the advances and discount accommodations extended by the Federal reserve bank to the borrowing bank "

APPENDIX XVIII

AMENDMENT TO THE FEDERAL RESERVE ACT RELATING TO EDGE LAW BANKS

(Approved June 14, 1920)

That section 25 (a) of the Federal Reserve Act, being the section added to said Act by the Act approved December 24, 1919, be amended so that the first sentence of the paragraph prescribing the amount of capital stock a corporation organized under that section is required to have and prescribing also the manner in which such capital stock must be paid in, said paragraph being the fourth paragraph following subparagraph (c) of said section, shall read as follows

"No corporation shall be organized under the provisions of this section with a capital stock of less than \$2,000,000, one-quarter of which must be paid in before the corporation may be authorized to begin business, and the remainder of the capital stock of such corporation shall be paid in installments of at least 10 per centum on the whole amount to which the corporation shall be limited as frequently as one installment at the end of each succeeding two months from the time of the commencement of its business operations until the whole of the capital stock shall be paid in *Provided, however,* That whenever \$2,000,000 of the capital stock of any corporation is paid in the remainder of the corporation's capital stock or any unpaid part of such remainder may, with the consent of the Federal Reserve Board and subject to such regulations and conditions as it may prescribe, be paid in upon call from the board of directors, such unpaid subscriptions, however, to be included in the maximum of 10 per centum of the national bank's capital and surplus which a national bank is permitted under the provisions of this Act to hold in stock of corporations engaged in business of the kind described in this section and in section 25 of the Federal Reserve Act as amended *Provided further,* That no such corporation shall have liabilities outstanding at any one time upon its debentures, bonds, and promissory notes in excess of ten times its paid-in capital and surplus

APPENDIX XIX

AMENDMENTS TO THE FEDERAL RESERVE ACT

(Approved February 27, 1921)

That section 11 of the act approved December 23, 1913, known as the Federal Reserve Act, as amended, be further amended by striking out the whole of subsection (m) and by substituting therefor a subsection to read as follows

"(m) Upon the affirmative vote of not less than five of its members, the Federal Reserve Board shall have power to permit Federal reserve banks to discount for any member bank notes, drafts, or bills of exchange bearing the signature or endorsement of any one borrower in excess of the amount permitted by section nine and section thirteen of this Act, but in no case to exceed twenty per centum of the member bank's capital and surplus *Provided, however,* That all such notes, drafts or bills of exchange discounted for any member bank in excess of the amount permitted under such sections shall be secured by not less than a like face amount of bonds or notes of the United States issued since April twenty-fourth, nineteen hundred and seventeen, for which the borrower shall in good faith prior to January 1, 1921, have paid or agreed to pay not less than the full face amount thereof, or certificates of indebtedness of the United States *Provided further,* That the provisions of this subsection (m) shall not be operative after October thirty-first, nineteen hundred and twenty-one"

That the first paragraph of the act approved December 24, 1919, known as the Edge Act, amending the Federal Reserve Act, be amended by adding at the end a proviso, so that the paragraph as amended will read as follows

"Sec 25 (a) Corporations to be organized for the purpose of engaging in international or foreign banking or other international or foreign financial operations, or in banking or other financial operations in a dependency or insular possession of the United States, either directly or through the agency, ownership, or control of local institutions in foreign countries, or in such dependencies or insular possessions as provided by this section, and to act when required by the Secretary of the Treasury as fiscal agents of the United States, may be formed by any number of natural persons, not less in any case than five *Provided,* That nothing in this section shall be construed to deny the right of the Secretary of the Treasury to use any corporation organized under this section as depositaries in Panama and the Panama Canal Zone, or in the Philippine Islands and other insular possessions and dependencies of the United States"

APPENDIX XX

AMENDMENTS TO THE FEDERAL RESERVE ACT INCORPORATED IN THE AGRICULTURAL CREDITS ACT OF MARCH 4, 1923

TITLE IV—AMENDMENTS TO THE FEDERAL RESERVE ACT

SEC 401 That the ninth paragraph of section 9 of the Federal reserve act is amended to read as follows

"No applying bank shall be admitted to membership in a Federal reserve bank unless (a) it possesses a paid-up, unimpaired capital sufficient to entitle it to become a national banking association in the place where it is situated under the provision of the national bank act, or (b) it possesses a paid-up, unimpaired capital of at least 60 per cent of the amount sufficient to entitle it to become a national banking association in the place where it is situated under the provisions of the national bank act and, under penalty of loss of membership complies with rules and regulations which the Federal Reserve Board shall prescribe fixing the time within which and the method by which the unimpaired capital of such bank shall be increased out of the net income to equal the capital which would have been required if such bank had been admitted to membership under the provisions of clause (a) of this paragraph *Provided*, That every such rule or regulation shall require the applying bank to set aside annually not less than 20 per cent of its net income of the preceding year as a fund exclusively applicable to such capital increase "

SEC 402 That the second paragraph of section 13 of the Federal Reserve Act is amended and divided into two paragraphs to read as follows

"Upon the indorsement of any of its member banks, which shall be deemed a waiver of demand, notice and protest by such bank as to its own indorsement exclusively, any Federal reserve bank may discount notes, drafts, and bills of exchange arising out of actual commercial transactions; that is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes, the Federal Reserve Board to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this act Nothing in this act contained shall be construed to prohibit such notes, drafts, and bills of exchange, secured by staple agricultural products, or other goods, wares, or

merchandise from being eligible for such discount, and the notes, drafts, and bills of exchange of factors issued as such making advances exclusively to producers of staple agricultural products in their raw state shall be eligible for such discount, but such definition shall not include notes, drafts, or bills covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States. Notes, drafts, and bills admitted to discount under the terms of this paragraph must have a maturity at the time of discount of not more than 90 days, exclusive of days of grace.

"Upon the indorsement of any of its member banks, which shall be deemed a waiver of demand, notice, and protest by such bank as to its own indorsement exclusively, and subject to regulations and limitations to be prescribed by the Federal Reserve Board, any Federal reserve bank may discount or purchase bills of exchange payable at sight or on demand which are drawn to finance the domestic shipment of nonperishable, readily marketable staple agricultural products and are secured by bills of lading or other shipping documents, conveying or securing title to such staples. *Provided*, That all such bills of exchange shall be forwarded promptly for collection, and demand for payment shall be made with reasonable promptness after the arrival of such staples at their destination. *Provided further*, That no such bill shall in any event be held by or for the account of a Federal reserve bank for a period in excess of 90 days. In discounting such bills Federal reserve banks may compute the interest to be deducted on the basis of the estimated life of each bill and adjust the discount after payment of such bills to conform to the actual life thereof."

SEC 403 That the fourth paragraph of section 13 of the Federal reserve act is amended to read as follows:

"Any Federal reserve bank may discount acceptances of the kinds hereinafter described, which have a maturity at the time of discount of not more than 90 days' sight, exclusive of days of grace, and which are indorsed by at least one member bank. *Provided*, That such acceptances if drawn for an agricultural purpose and secured at the time of acceptance by warehouse receipts or other such documents conveying or securing title covering readily marketable staples, may be discounted with a maturity at the time of discount of not more than six months' sight, exclusive of days of grace."

SEC 404 That the Federal reserve act is amended by adding at the end of section 13 a new section to read as follows:

"SEC 13a Upon the indorsement of any of its member banks, which shall be deemed a waiver of demand, notice, and protest by such bank as to its own indorsement exclusively, any Federal reserve bank may, subject to regulations and limitations to be prescribed by the Federal Reserve Board, discount notes, drafts, and bills of exchange issued or drawn for an agricultural purpose, or based upon live stock, and having a maturity, at the time of discount, exclusive of days of grace, not exceeding nine months, and such notes, drafts, and bills of exchange may be offered as collateral

security for the issuance of Federal reserve notes under the provisions of section 16 of this act *Provided*, That notes, drafts, and bills of exchange with maturities in excess of six months shall not be eligible as a basis for the issuance of Federal reserve notes unless secured by warehouse receipts or other such negotiable documents conveying or securing title to readily marketable staple agricultural products or by chattel mortgage upon live stock which is being fattened for market

"That any Federal reserve bank may, subject to regulations and limitations to be prescribed by the Federal Reserve Board, rediscount such notes, drafts, and bills for any Federal intermediate credit bank, except that no Federal reserve bank shall rediscount for a Federal intermediate credit bank any such note or obligation which bears the indorsement of a nonmember State bank or trust company which is eligible for membership in the Federal reserve system, in accordance with section 9 of this act

"Any Federal reserve bank may also buy and sell debentures and other such obligations issued by a Federal intermediate credit bank or by a national agricultural credit corporation, but only to the same extent as and subject to the same limitations as those upon which it may buy and sell bonds issued under Title I of the Federal farm loan act

"Notes, drafts, bills of exchange or acceptances issued or drawn by cooperative marketing associations composed of producers of agricultural products shall be deemed to have been issued or drawn for an agricultural purpose, within the meaning of this section, if the proceeds thereof have been or are to be advanced by such association to any members thereof for an agricultural purpose, or have been or are to be used by such association in making payments to any members thereof on account of agricultural products delivered by such members to the association, or if such proceeds have been or are to be used by such association to meet expenditures incurred or to be incurred by the association in connection with the grading, processing, packing, preparation for market, or marketing of any agricultural product handled by such association for any of its members *Provided*, That the express enumeration in this paragraph of certain classes of paper of cooperative marketing associations as eligible for rediscount shall not be construed as rendering ineligible any other class of paper of such associations which is now eligible for rediscount

"The Federal Reserve Board may, by regulation, limit to a percentage of the assets of a Federal reserve bank the amount of notes, drafts, acceptances, or bills having a maturity in excess of three months, but not exceeding six months, exclusive of days of grace, which may be discounted by such bank, and the amount of notes, drafts, bills, or acceptances having a maturity in excess of six months, but not exceeding nine months, which may be discounted by such bank"

SEC 405 That section 14 of the Federal reserve act is amended by adding at the end thereof a new paragraph to read as follows

"(f) To purchase and sell in the open market, either from or to domestic

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banks, firms, corporations, or individuals, acceptances of Federal intermediate credit banks and of national agricultural credit corporations, whenever the Federal Reserve Board shall declare that the public interest so requires"

SEC 406 That section 15 of the Federal reserve act is amended by adding at the end thereof a new paragraph to read as follows

"The Federal reserve banks are hereby authorized to act as depositories for and fiscal agents of any national agricultural credit corporation or Federal intermediate credit bank"

SEC 407 That the act entitled "An act to amend the act approved December 23, 1913, known as the Federal reserve act," approved April 13, 1920, is repealed

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